COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET FOR THE LIABILITIES ASSOCIATED WITH ASH POND ASSET RETIREMENT OBLIGATIONS	)))))	CASE NO. 2015-00187

ORDER

On June 10, 2015, Duke Energy Kentucky, Inc. ("Duke Kentucky") filed an application seeking approval to establish regulatory assets for the income statement impacts, including gains, losses, accretion and depreciation, arising from liabilities associated with Duke Kentucky's Asset Retirement Obligations ("ARO")[1] with respect to the coal ash pond located at its East Bend Generating Station ("East Bend").[2] In addition, Duke Kentucky has requested the creation of a regulatory asset to defer actual costs incurred to comply with newly enacted federal regulations pertaining to coal ash ponds, as well as permission to calculate and defer carrying costs associated with the regulatory assets requested herein.

There are no intervenors in this proceeding. Duke Kentucky responded to four rounds of data requests from Commission Staff. The matter now stands submitted to the Commission for a decision based on the evidentiary record.

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[1] *See* Financial Accounting Standards Board Accounting Codification ("ASC") Topic 410-20, *Asset Retirement Obligations*.

[2] Duke Kentucky also intends to reclassify the existing Cost of Removal reserves related to the ash pond closure in Account 108, Accumulated Provision, for depreciation of electric utility plant to Account 182.3, Other Regulatory Assets.

BACKGROUND

Pursuant to KRS 278.220, the system of accounts for "electric companies shall conform as nearly as practicable to the system adopted or approved by the Federal Energy Regulatory Commission" ("FERC"). The FERC Uniform System of Accounts ("FERC USoA")[3] states:

> (A) An asset retirement obligation represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. An asset retirement cost represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost shall be stated at the fair value of the asset retirement obligation in the period in which the obligation is incurred.[4]

On April 17, 2015, the U.S. Environmental Protection Agency published the Disposal of Coal Combustion Residuals from Electric Utilities rule ("CCR Final Rule"). Although the CCR Final Rule became effective on October 19, 2015, the accounting for the legal obligation must be recognized on April 17, 2015, the publication date of the CCR Final Rule. Therefore, as of April 30, 2015, Duke Kentucky quantified its ARO liability with respect to the East Bend ash pond at approximately $116 million.[5] In addition, Duke Kentucky quantified an ARO in the amount of $35 million for the related accretion expense.[6] Finally, Duke Kentucky quantified a proposed regulatory asset for

[3] Codified as 18 C.F.R. Part 101.

[4] *Id.*, General Instructions, subpart (25), Accounting for asset retirement obligations.

[5] Application at 6.

[6] *Id.*

approximately $1.8 million for engineering studies and analysis, and other expenses ("CCR Compliance Costs") in 2015 and additional compliance costs thereafter.[7]

Pursuant to the requirements of the FERC USoA, Duke Kentucky must begin to depreciate and accrete the ARO once it is recognized. Duke Kentucky began recognizing the depreciation and accretion expenses in May 2015. The amount of these expenses is based upon the ARO recognized as of April 30, 2015, and will be subject to prospective adjustment as the underlying cost estimates and timing change based on updated compliance costs.[8] Duke Kentucky projects that, at the end of 2015, the ARO-related depreciation expense will be approximately $3 million and the accretion expense will be $2.9 million.[9] Any gain or loss will be recognized upon completion of the East Bend ARO project.

Duke Kentucky states that the actual ARO settlement costs should be recoverable through appropriate rate mechanisms in the future; however, at present, the specific timeframe, cost, and manner for doing so have not been determined.[10] In the meantime, Duke Kentucky indicated that this lack of recovery creates a mismatch of revenues and expenses in its financial statements because accretion and depreciation expense will be recognized monthly beginning in May 2015, even though the revenue will not be recognized until some future period.[11] These ARO-related expenses, therefore, reduce Duke Kentucky's return and understate its true financial performance

[7] *Id.*

[8] *Id.* at 5.

[9] *Id.*

[10] *Id.*

[11] *Id.*

in the short-term and when the actual ash pond closure costs are being recovered in the future, Duke Kentucky's financial performance will be overstated.[12] To avoid this outcome, Duke Kentucky requests the Commission to authorize the establishment of regulatory assets of approximately $116 million and $35 million, respectively, for deferred depreciation and accretion expenses. Duke Kentucky is also requesting that all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances on December 31, 2015, be recorded as regulatory assets.[13]

Duke Kentucky anticipates incurring incremental expenses in 2015 and in the future that are directly attributed to compliance under the newly promulgated CCR Final Rule.[14] Duke Kentucky is currently analyzing the status of its existing ash pond at East Bend in order to determine whether the pond complies with the CCR Final Rule. This analysis requires engineering studies and analysis; based upon its current estimates, Duke Kentucky will incur approximately $1.8 million in CCR Compliance Costs in 2015 and additional compliance costs thereafter.[15] Duke Kentucky proposes that costs to comply with newly enacted federal regulations be deferred as incurred.[16] Duke Kentucky estimates that it will incur total actual costs of $107.7 million from 2015–2051 related to the closure of the ash pond at East Bend for which it seeks approval to defer ("CCR Compliance Regulatory Asset") and proposes to record actual amounts

[12] *Id.* at 5–6.

[13] *Id.* at 6.

[14] *Id.*

[15] *Id.*

[16] *Id.*

spent for recovery in future rates.[17] The estimate is based on studies which indicate that the ash basin at East Bend will most likely be excavated to an on-site landfill by 2021.[18] The CCR Compliance Regulatory Asset will represent only the cash expended to satisfy the ARO liability related to closing the ash basin at East Bend and the carrying costs recorded.[19]

The proposed carrying costs will be based on Duke Kentucky's annual weighted average cost of capital ("WACC"), calculated in a manner similar to its allowance for funds used during construction calculation.[20] The carrying costs are to be calculated using the WACC and recorded monthly on the unamortized CCR Compliance Regulatory Asset balance.[21]

DISCUSSION

The Commission has previously approved regulatory assets for Duke Kentucky and other jurisdictional utilities. Such approval has been granted when a utility has incurred (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry-sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a

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[17] Duke Kentucky's Response to Commission Staff's First Request for Information, Item 4.b.

[18] *Id.*

[19] *Id.*, Item 4.d.

[20] *Id.*

[21] *Id.*

saving that fully offsets the cost.[22] Duke Kentucky believes its request to establish regulatory assets for the ARO-related gains and losses, depreciation and accretion expenses is consistent with the second example listed above, as the ARO-related gain or loss, depreciation and accretion expenses result from the accounting requirements of FERC USoA and ASC Topic 410-20.[23]

The Commission has previously approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses for Louisville Gas and Electric Company[24] and Kentucky Utilities Company[25] when those utilities adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*.[26] The Commission also approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses for East Kentucky Power Cooperative in Case No. 2014-00432[27] when that utility recognized an ARO due to the associated ash transfer and closure costs for ash ponds at its Dale Station and asbestos abatement projects at its Dale and Cooper Stations.

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[22] Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008), Final Order at 4.

[23] Application at 9.

[24] Case No. 2003-00426, *Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003).

[25] Case No. 2003-00427, *Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003).

[26] Statement of Financial Accounting Standards No. 143 is now codified as ASC Topic 410.

[27] Case No. 2014-00432, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations* (Ky. PSC July 21, 2015).

The Commission recently approved, in part, Duke Kentucky's request for a Certificate of Public Convenience and Necessity to construct the West Landfill at the East Bend location in Case No. 2015-00089.[28] Although Duke Kentucky had requested that the Commission approve eight phases of the West Landfill construction, the Commission only approved phase one, while phases two through eight were denied without prejudice. In that proceeding, Duke Kentucky testified that it has obtained a permit from the Kentucky Division of Waste Management for the West Landfill to receive various forms of waste, including flue gas desulfurization waste, fly ash and bottom ash from the East Bend Station.[29] Duke Kentucky further testified that the West Landfill will allow Duke Kentucky to comply with the CCR Final Rule in a cost-effective manner in the event the East Bend ash pond would need to be closed.[30]

The Commission has reviewed the information provided by Duke Kentucky and finds that the proposed regulatory assets should be authorized.

IT IS THEREFORE ORDERED that:

1. The accounting treatment requested by Duke Kentucky to classify gains, losses, depreciation (including its request to reclassify the existing Cost of Removal reserves) and accretion expense related to its East Bend ash pond as regulatory assets is approved for 2015 and subsequent years.

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[28] Case No. 2015-00089, *Application of Duke Kentucky, Inc. for a Declaratory Order that the Construction of a New Landfill Constitutes an Ordinary Extension in the Usual Course of Business or, in the Alternative, for a Certificate of Public Convenience and Necessity* (Ky. PSC July 24, 2015).

[29] *Id.*, Direct Testimony of Tammy Jett at 6.

[30] *Id.* at 15.

2. The accounting treatment requested by Duke Kentucky to classify actual CCR Compliance Costs related to its East Bend ash pond as a CCR Compliance Regulatory Asset is approved for 2015 and subsequent years.

3. The accounting treatment requested by Duke Kentucky to defer appropriate carrying charges on its unamortized CCR Compliance Regulatory Asset, as described herein, is approved for 2015 and subsequent years.

4. The regulatory asset and liability accounts established in this case are for accounting purposes only.

5. Duke Kentucky shall, within 14 days of the date of this Order, file with the Commission the accounting entries made on its books to effectuate the creation of the regulatory assets.

6. Duke Kentucky shall file annually updated ARO calculations reflecting any studies, reports, or change in other assumptions for the East Bend ARO balance as originally recorded at December 31, 2015. The annual update shall be based upon the balances as of December 31 of each year and the updated calculations shall be submitted at the same time Duke Kentucky files its annual report with the Commission.

7. Duke Kentucky shall file annually an updated CCR Compliance Regulatory Asset report reflecting all actual costs and carrying costs incurred during the year. The report should be broken down by month and include the beginning balance, the total monthly costs incurred by account, the monthly carrying costs, and the monthly ending balance. The annual report shall be submitted at the same time Duke Kentucky files its annual report with the Commission beginning in 2016.

8. Any document filed in the future pursuant to ordering paragraphs 5, 6, and 7 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission

ENTERED

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KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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