DUKE ENERGY®

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**VIA OVERNIGHT DELIVERY**

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APR 10 2015
PUBLIC SERVICE
COMMISSION

April 9, 2015

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard, P.O. Box 615
Frankfort, Kentucky 40602-0615

**Re:** ***Case No. 2015-________***
*In the Matter of the Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Depreciation Expense of its East Bend Unit 2 Generating Station*

Dear Mr. Derouen:

Enclosed please find an original and twelve copies of the Application of Duke Energy Kentucky, Inc. for filing in the above referenced matter.

Please date-stamp the two copies of the letter and the filing and return to me in the enclosed envelope.

Sincerely,

Rocco D'Ascenzo
Associate General Counsel
rocco.d'ascenzo@duke-energy.com

cc: Hon. Jennifer Hans

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APR 10 2015

PUBLIC SERVICE COMMISSION

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**IN THE MATTER OF:**

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| **THE APPLICATION OF DUKE ENERGY KENTUCKY, INC FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET FOR THE DEPRECIATION EXPENSE OF ITS EAST BEND UNIT 2 GENERATING STATION** | ) ) ) ) ) ) | **CASE NO. 2015-______** |

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## APPLICATION

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Comes now Duke Energy Kentucky, Inc. ("Duke Energy Kentucky" or "Company"), by counsel, pursuant to KRS 278.030(1), KRS 278.040(2), KRS 278.220 and other applicable law, and does hereby request the Kentucky Public Service Commission ("Commission") to approve the establishment of a regulatory asset the depreciation expense associated with Duke Energy Kentucky's acquisition of the 31 percent interest in East Bend Unit 2 Generating Station ("East Bend"). A strict application of Federal Regulatory Energy Commission (FERC) rules regarding depreciation on acquisition adjustments results in excessive depreciation expense.

### I. Applicant Information and General Filing Requirements

1. Duke Energy Kentucky is an investor-owned utility engaged in the business of furnishing natural gas and electric services to various municipalities and unincorporated areas in Boone, Bracken, Campbell, Gallatin, Grant, Kenton, and Pendleton Counties in the Commonwealth of Kentucky.

2. Pursuant to 807 KAR 5:001, Section 14(2), Duke Energy Kentucky is a Kentucky corporation that was originally incorporated on March 20, 1901, is in good standing and, as a

public utility, as that term is defined in KRS 278.010(3), is subject to the Commission's jurisdiction.

3. Pursuant to 807 KAR 5:001, Section 14(1), Duke Energy Kentucky's business address is 139 East Fourth Street, Cincinnati, Ohio 45202. Duke Energy Kentucky's local office in Kentucky is Duke Energy Envision Center, 4580 Olympic Boulevard, Erlanger, Kentucky 41018, and electronic mail address is KYfilings@duke-energy.com.

## II. Background

4. Because of its obligation to generate and transmit electric power to its customers, Duke Energy Kentucky must ensure that it continually maintains an adequate portfolio of low cost and reliable generation in its system. In direct observance of that obligation, Duke Energy Kentucky requested and was granted by the Commission in Case No. 2014-00201, a Certificate of Public Convenience and Necessity ("CPCN") to acquire the 31% interest in East Bend from Dayton Power & Light Company ("DP&L"). Duke Energy Kentucky purchased DP&L's 31% interest for $12.4 million. The original cost of the interest acquired was $214 million and accumulated depreciation of $138 million for a net book value of $76 million.

5. 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").

6. FERC requires the use of a systematic and rational depreciation methodology by all utilities subject to its jurisdiction, including Duke Energy Kentucky.[1] A recent ruling by FERC in a case involving one of the Company's affiliated operating companies has led the Company to conclude that FERC will require the application of the depreciation rate currently

[1] *See* Federal Energy Regulatory Commission, Order 618, Docket No. RM99-7-000, Depreciation Accounting, 65 Fed. Reg. 47, 664-47, 668 (July 27, 2000).

applied to Duke Energy Kentucky's original share of East Bend to also be applied to the $214 million original plant cost of the recently acquired interest in East Bend, not the $12.4 million net purchase price.[2]

7. Applying the depreciation rate to the original plant cost, as mandated by FERC, would result in the full depreciation of the East Bend interest acquired from DP&L over a period of approximately four years, which is well short of the expected remaining service life of East Bend of twenty-seven years based on currently approved depreciation rates. Current depreciation rates assume a terminal date or expected retirement date of East Bend in 2041. In acquiring the interest in East Bend, the Company intended to depreciate the investment cost of $12.4 million over the remaining useful life of East Bend as it would any other capital addition to the plant. Thus, the FERC ruling, which narrows and restricts the Company's discretion to record depreciation of the East Bend investment, places the Company in a position where it is unable to act as it intended, and as stated, in Case No. 2014-00201.

8. In practical terms, the FERC ruling will dictate that Duke Energy Kentucky record approximately $3.833 million in annual depreciation expense on its books in 2015, 2016 and 2017 and $902,000 in depreciation expense on its books in 2018, when the acquired interest in East Bend will become fully depreciated for FERC's purposes, well before the end of its useful life. These expenses vastly exceed the $222,000, which Duke Energy Kentucky intended to include as annual depreciation expense over East Bend's expected remaining useful life of 27 years, which: (a) results from applying the depreciation rate to the net purchase price of the East

[2] *See In the Matter of Carolina Power and Light Co., Duke Energy Progress, Inc. and Duke Energy Progress, Inc.* Docket Nos. ER 13-1313-000, ER 13-1313-001, ER 13-2186-000, ER13-2186-001, EL 14-2-000, EL14-2-001 (Consolidated) and AC 13-170-000, 149 FERC ¶ 61,266 (Dec. 22, 2014). The composite depreciation rate is the weighted average depreciation rate that applies to all the depreciable assets within the Company's rate base.

Bend interest; and (b) corresponds to the expected period in which East Bend will be used and useful.

9. The net effect of this change is that the Company's income statements will include four years of significantly higher depreciation expense followed by twenty-three years of no depreciation expense whatsoever for the acquired interest in East Bend. This will therefore understate the Company's true financial performance for four years and then overstate its financial performance for twenty-three years. The FERC accounting method therefore leads to a mismatch on the Company's ratemaking accounts and, if unchanged, would be inconsistent with the intended results of the stipulation and settlement regarding the purchase of the additional interest in East Bend. Strict application of the FERC's accounting method therefore results in a distortion of sound depreciation principles inasmuch as the depreciation of the $12.4 million investment made by Duke Energy Kentucky is not recognized over with the useful life of the asset.

10. In other precedent, FERC has held that state regulatory actions that differ from FERC requirements should be reconciled through the employment of regulatory assets and liabilities.[3] Accordingly, Duke Energy Kentucky is proposing to record the difference between the FERC mandated annual depreciation expense and the originally intended $0.2 million annual depreciation expense from Case No. 2014-00201 as a regulatory asset until the acquired East Bend interest is fully depreciated over four years and, thereafter, amortize the regulatory asset over the following twenty-three years, which should correspond with the remaining estimated

[3] *See In the Matter of Ohio Edison Company, et al.*, Order, F.E.R.C Docket No. DR 97-3-000 (Aug. 4, 1998).

useful life of East Bend.[4] This approach would allow Duke Energy Kentucky to comply with FERC's depreciation rules while also spreading the depreciation expense, for ratemaking purposes, over the remaining life of East Bend.

**III. Request to Establish a Regulatory Asset**

11. A regulatory asset is created when a utility is authorized to capitalize an expenditure that under traditional accounting rules would be recorded as a current expense. The reclassification of an expense to a capital item allows the utility the opportunity to request recovery in future rates of the amount capitalized. The authority to establish regulatory assets arises out of the Commission's plenary authority to regulate utilities under KRS 278.040 and to "establish a system of accounts to be kept by utilities subject to its jurisdiction… and may prescribe the manner in which such accounts shall be kept."[5]

12. Utilities must obtain Commission approval for accounting adjustments before establishing any expense as a new regulatory asset. Specifically, the Commission stated in Case No. 2001-00092, "Therefore, the Commission finds that in the future, ULH&P shall formally apply for Commission approval before accruing a cost as a deferred asset, regardless of the rate-making treatment that the Commission has afforded a similar cost in previous rate case proceedings."[6]

13. The Commission has exercised its discretion to approve regulatory assets where a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or

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[4] The amount of this regulatory expense would be $3.611 million in 2015, 2016 and 2017 and $680,000 in 2018, which equals the depreciation expense mandated by FERC minus the originally intended depreciation expense set forth in Case No. 2014-00201.

[5] KRS 278.220.

[6] *In the Matter of Adjustment of Gas Rates of The Union Light, Heat and Power Company,* Final Order, Case No. 2001-00092 (Ky. P.S.C., Jan. 31, 2002).

administrative direction; (3) an expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[7] In exercising discretion to allow the creation of a regulatory asset, the Commission's overarching consideration has been the context in which the regulatory asset is sought to be established and not necessarily the specific nature of the costs incurred.[8]

14. Duke Energy Kentucky's request satisfies the criteria because the requested regulatory asset is derived from an expense resulting from an accounting directive of FERC. Moreover, it leads to a fair, just and reasonable result by ensuring that the net depreciation expense recorded on the Company's income statements and ultimately recovered from customers is consistent with the actual useful life of East Bend.

15. Until such time as this Application may be granted, Duke Energy Kentucky will have to continue to record the East Bend depreciation expense as mandated by FERC. Once approval is granted to create a regulatory asset, then Duke Energy Kentucky will make retroactive changes to its monthly 2015 income statements. To minimize the disruptions in preparing these financial statements, Duke Energy Kentucky respectfully requests the

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[7] *See In the Matter of 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*, Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008); *In the Matter of the Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00456 (Ky. P.S.C., Dec. 22, 2008); *In the Matter of the Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00457 (Ky. P.S.C., Dec. 22, 2008); *In the matter of the Joint Application of Duke Energy Kentucky, Inc., Kentucky Power Company, Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to Certain Payments Made to the Carbon Management Research Group and the Kentucky Consortium for Carbon Storage,* Final Order, Case No. 2008-00308 (Ky. P.S.C., Oct. 30, 2008); *In the Matter of the Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations,* Final Order, Case No. 2001-00169 (Ky. P.S.C., Dec. 3, 2001).

[8] *In the Matter of 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*, Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008).

Commission's approval of this Application on or before July 1, 2015 so to book the entry during the second quarter of 2015.

16. At the time of its next rate case, the Company will file an updated depreciation study and provide a detailed description of the how the remaining balance of its full investment in East Bend, plus the regulatory asset will be recovered in base rates.

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky respectfully requests that the Commission enter an Order:

1. Approving the establishment of a regulatory asset for the amount set forth herein and allowing said regulatory asset to be amortized over a period of twenty-three years;

2. Granting the relief requested herein by Order dated on or before July 1, 2015; and;

3. Granting Duke Energy Kentucky all other additional relief to which it may appear entitled.

This 7th day of April, 2015.

## VERIFICATION

**State of North Carolina** )
) **SS:**
**County of Mecklenburg** )

The undersigned, Will A. Garrett, being duly sworn, deposes and says that he is the Director of Accounting Research and that the matters set forth in the foregoing Application are true and correct to the best of his information, knowledge and belief.

Will A. Garrett
_______________________________
Will A. Garret, Affiant

Subscribed and sworn to me by Will A. Garrett on this 7 day of April, 2015.

Rita M. Simmons
_______________________________
NOTARY PUBLIC

RITA M SIMMONS
Notary Public
Mecklenburg County
North Carolina
My Commission Expires Feb 26, 2018

My Commission expires: February 26, 2018

Respectfully submitted,

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*Counsel for Duke Energy Kentucky, Inc.*

## CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing Application of Duke Energy Kentucky, Inc. has been served via overnight mail to the following party on this 9th day of April, 2015.

Hon. Jennifer Hans
Office of the Attorney General
Utility Intervention and Rate Division
1024 Capital Center Drive
Frankfort, Kentucky 40601

Rocco O. D'Ascenzo