

Matthew G. Bevin
Governor

Charles G. Snavelly
Secretary
Energy and Environment Cabinet



Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

Michael J. Schmitt
Chairman

Robert Cicero
Vice Chairman

Daniel E. Logsdon Jr.
Commissioner

March 10, 2017

Via U.S. Mail and electronic mail

PSC STAFF OPINION 2017-006

Mr. Rocco D'Ascenzo
Duke Energy Kentucky, Inc.
139 East Fourth Street ML 1303
Cincinnati, OH 45201-0960

Re: Request for Staff Opinion - Certificate of Public Convenience and Necessity

Dear Mr. D'Ascenzo

The Commission received on February 7, 2017, your letter on behalf of Duke Energy Kentucky, Inc. ("Duke Kentucky") requesting a Commission Staff Opinion regarding Duke Kentucky's need for a Certificate of Public Convenience and Necessity ("CPCN") to invest approximately \$16 to \$20 million in a new customer information system ("CIS"). Your letter asserts that since the CIS is a software solution, not a physical asset, the investment in the CIS is not subject to the CPCN requirements set forth in KRS 278.020(1) and no CPCN is needed. Alternatively, you assert that if the CIS is deemed to be a physical asset that is subject to the CPCN statute, the exception in the CPCN statute for "an ordinary extension of an existing system in the ordinary course of business" should apply to the CIS investment. This opinion represents Commission Staff's interpretation of the law as applied to the facts presented, is advisory in nature, and is not binding on the Public Service Commission should the issues be formally presented for Commission resolution.

As background for your request, you provide the following facts:

Duke Energy Corp. (Duke Energy) is intending to upgrade the existing multiple customer information systems (CIS) upon which its regulated utilities have relied to interact with their respective customers. This investment will yield a single CIS (NEW CIS) platform across Duke Energy's entire regulated utility footprint, including in the Commonwealth of Kentucky. Duke Energy Corp., currently operates with four

separate CIS that facilitate core meter reading, billing and customer service operations across six utility jurisdictions, including Kentucky, Ohio, Indiana, North Carolina, South Carolina and Florida. These four distinct systems are the only major technology platforms that have not been consolidated through mergers over the past eleven years. Each of these systems varies in age, technological capability, cost to operate and upgradability. None of these existing systems is considered to possess the ability or sufficient upgradability to meet growing customer needs or their increasingly desired levels of service across and throughout Duke Energy Corp.'s utility footprint.

The current CIS used by Duke Energy Kentucky was developed beginning in 1987 and implemented in 1993. [T]his legacy system is nearing end of life and not capable of meeting the customer's evolving needs at their desired pace. Rather, the system must be replaced to provide a more stable platform, greater flexibility, ease of configuration and ability to offer more advanced rates and billing structures, as well as services to customers, than what is currently possible. The legacy Duke Energy Kentucky CIS [is now] cumbersome, difficult to update and limited in functionality compared to newer systems that are currently available. Continued investment in an antiquated technology platform is not practical or sustainable. Customer information systems, just like any other software solution, periodically require replacement to deliver on capabilities required by business operations and, more importantly, customers.

The NEW CIS will consolidate Duke Energy Corp.'s utility operating companies' existing legacy, outdated CIS billing systems into one single state-of-the-art customer service platform that will be implemented across Duke Energy Corp. The costs of developing this NEW CIS will be shared proportionally among all of Duke Energy Corp.'s current electric utilities and combination electric/natural gas utilities. (footnote omitted).

Duke Energy Corp. is undertaking preplanning work for the NEW CIS for all of its jurisdictions in 2017, with system development processes beginning in 2018. To the best of its knowledge and belief, none of Duke Energy Corp.'s regulated utility operating companies are required to seek regulatory approval for making the NEW CIS



software upgrade investment in their respective regulatory jurisdictions.

Further, you state that it is not viable, cost-effective or prudent to maintain multiple existing CISs, and it is not cost-effective to maintain a single existing CIS for Duke Energy Kentucky.

Staff begins its analysis with KRS Chapter 278. The CPCN statute, KRS 278.020(1) provides in pertinent part:

No person, partnership, public or private corporation, or combination thereof shall commence providing utility service to or for the public or begin the construction of any plant, equipment, property, or facility for furnishing to the public any of the services enumerated in KRS 278.010, except retail electric suppliers for service connections to electric-consuming facilities located within its certified territory and ordinary extensions of existing systems in the usual course of business, until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction.

Although KRS Chapter 278 contains no definition of the words "plant," "equipment," or "property," it does define "facility." Specifically, KRS 278.010(11) defines "facility" as "include[ing] all property, means, and instrumentalities owned, operated, leased, licensed, used, furnished, or supplied for, by, or in connection with the business of any utility." In addition, the Kentucky Supreme Court has recently defined the term "property" as "include[ing] everything which is the subject of ownership, corporeal or incorporeal, tangible or intangible, visible or invisible, real or personal..." *Extendicare Homes, Inc. v. Whisman*, 478 S.W.3d 306, 326 (Ky. 2015) (citation omitted). In light of the Court's definition of "property," Staff concludes that the CIS will be a facility used by Duke Kentucky in connection with its business of providing electric and gas service to customers in Kentucky, and, thus, the CPCN statute is applicable unless an exception applies.

The only potential exemption for the CIS is if it qualifies as "an ordinary extension of an existing system in the ordinary course of business." The Commission's Administrative Regulation, 807 KAR 5:001, Section 15(3), provides the following criteria in applying this exempt:

Extensions in the ordinary course of business. A certificate of public convenience and necessity shall not be required for extensions that do not create wasteful duplication of plant, equipment, property, or facilities, or conflict with the existing certificates or service of other utilities operating in the same

area and under the jurisdiction of the commission that are in the general or contiguous area in which the utility renders service, and that do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers.

In support of the application of the "ordinary extension in the usual course" exemption, Duke Kentucky states that the new CIS: 1) will not create wasteful duplication because it will replace an antiquated system in need of significant upgrades; 2) will not conflict with the existing certificates or service of other utilities under the Commission's jurisdiction that operate in the same area as Duke Kentucky; 3) will not involve sufficient capital outlay to materially affect Duke Kentucky's financial condition; and 4) will not on its own result in increased rates to customers. With respect to the capital outlay for the CIS, Duke Kentucky notes that its share of the total cost is projected to be \$16 to \$20 million. The cost is to be incurred over five to seven years, with the costs allocated on the basis of customer accounts, resulting in combination electric and gas customers paying more than electric only or gas only customers.

Based on a review of Duke Kentucky's 2015 Annual Report, its December 2016 monthly financial statements, and the Duke Energy Corp. website, it appears that Duke Kentucky's electric net plant in service is approximately \$791,900,000, and its gas net plant in service is approximately \$318,800,000. Duke Kentucky has approximately 80,000 combination electric and gas customers, 60,000 electric only customers, and 20,000 gas only customers. Utilizing a total estimated cost to Duke Kentucky of \$20 million for the CIS, and allocating that cost based on electric and gas customers, the result is an increase in electric net plant of approximately 2.6 percent and an increase in gas net plant of 1.5 percent.

Considering that the existing CIS is over 30 years old, its replacement will not create wasteful duplication of plant, nor will it conflict with the certificates or service of any other utilities under the Commission's jurisdiction that operate in the same area as Duke Kentucky. Staff also opines that the CIS is exempt from a CPCN since it will not itself result in increased rates to customers and will not involve sufficient capital outlay to materially affect its existing financial condition if Duke Kentucky does not issue any new debt or equity to finance the CIS. However, if new debt or equity is to be issued to finance the CIS, there will be a material impact on Duke Kentucky's financial condition and the exemption would no longer be applicable and a CPCN would be required.

Finally, Staff notes that in conjunction with a rate case filed in 2009 by Water Service Corporation of Kentucky, the Commission reviewed a new customer information system that had been installed by the utility's parent for use by multiple affiliates.¹ Based on the evidence in that case, the Commission disallowed rate recovery of the cost of the new system, finding that the utility had not met its burden of proof.

¹ Case No. 2008-00563, xxx (Ky. PSC Nov. 9, 2009)

Mr. Rocco D'Ascenzo

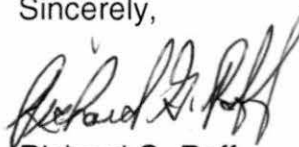
March 10, 2017

Page 5

Specifically, a benefit analysis had never been performed to determine the financial impact of the computer software or to identify the benefits to each affiliate, particularly the Kentucky affiliate. Duke Kentucky's request for a Staff Opinion is silent on the performance of an analysis to determine the reasonableness of investing \$16 to \$20 million in a CIS and the benefits to Kentucky customers. Thus, this Opinion does not address that issue.

This letter represents Commission Staff's interpretation of the law as applied to the facts presented. This opinion is advisory in nature and not binding on the Commission should the issues herein be formally presented for Commission resolution. Questions concerning this opinion should be directed to Richard Raff, Commission General Counsel, at (502) 782-2588.

Sincerely,



Richard G. Raff
General Counsel

RGR/ph