COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Electronic Application of Duke Energy Kentucky, Inc., for: 1) An Adjustment of the Electric Rates; 2 Approval of an Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and Relief	:	**Case No. 2017-00321**

BRIEF OF THE KROGER CO.

The Kroger Co. ("Kroger") submits this Brief in support of its recommendations with respect to Duke Energy Kentucky, Inc.'s ("Duke") Application for an adjustment of its electric rates.

ARGUMENT

1. Customers Should Receive The Full Benefit Of The Tax Savings Provided By The Tax Cuts and Jobs Act ("TCJA").

The reduction in the corporate tax rate per the TCJA will reduce Duke's federal income tax expense for regulatory purposes. This reduction in tax expense should directly reduce the revenue requirement in this case. Viewed in isolation, this single component of the change in tax law, i.e., the reduction in the tax rate from 35 percent to 21 percent reduces Duke's revenue requirement by approximately $10.6 million.[1]

Additionally, the TCJA has significant implications for Duke's Accumulated Deferred Income Taxes ("ADIT"). Duke accumulates these deferred income taxes in the ADIT on its regulatory books in an amount equal to this anticipated future tax liability. Now that the corporate income tax rate has been reduced by 40 percent,[2] Duke's anticipated future tax liability has also decreased by a comparable amount. As of January 1, 2018, when the new tax rates became effective, a substantial portion of the ADIT on Duke's books will be considered to be "*excess*" ADIT.[3] This excess ADIT should be returned to customers.

[1] Justin Bieber Direct, page 5.
[2] $1 - (21 \div 35) = 40\%$.
[3] Justin Bieber Direct, pages 5-6.

During the evidentiary hearing Duke agreed to flow back 100 percent of the benefit of the TCJA as of January 1, 2018.[4] Accordingly, the Commission should reduce the revenue requirement in an amount that provides customers with the full benefit of the tax savings provided by the TCJA. The Company's revenue requirement in this case should be adjusted to reflect the direct impact to its cost-of-service and excess ADIT should be credited to customers starting with the rate effective period in this general rate case.

2. The Commission Should Reject Duke's Proposed Distribution Capital Investment Reconciliation Mechanism (DCI Rider)

Duke is proposing a DCI Rider as a mechanism to track costs for specific new and Commission-approved initiatives designed to improve the safety, reliability, and integrity of its delivery system. In this case, Duke is proposing to include the Targeted Underground Program in the DCI Rider. The Company will also propose new programs to be included in the rider for Commission review in the future.[5] The DCI Rider proposed by Duke would represent a drastic change in the way in which distribution investments are recovered. As Duke acknowledged in response to Staff-DR-02-055, the Commission has never approved a mechanism similar to the proposed DCI Rider for any Kentucky jurisdictional utility. Kroger recommends that the Commission reject the proposed DCI Rider. The DCI Rider proposal amounts to single-issue ratemaking and reduces the Company's incentive to manage its costs effectively.

Single-issue ratemaking occurs when utility rates are adjusted in response to a change in a single cost or revenue item considered in isolation. It ignores the multitude of other factors that otherwise influence rates, some of which could, if properly considered, move rates in the opposite direction from the single-issue change.[6] Setting rates based on a single cost or revenue item runs contrary to the basic principles of traditional utility regulation. When regulatory commissions determine the appropriateness of a rate or charge that a utility seeks to impose on its customers, the standard practice is to review and consider all relevant factors, rather than just a single factor. To consider some costs in isolation might cause a commission to allow a utility to increase rates to recover higher costs in one area without recognizing counterbalancing savings in another area. Alternatively, a single revenue item considered in isolation might cause a decrease in rates without recognizing counterbalancing cost increases

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[4] Tr. (March 7, 2018) at 11:15:13.
[5] Anthony Platz Direct, page 25.
[6] Justin Bieber Direct, pages 12.

in other areas. For these reasons, single-issue ratemaking, absent a compelling public interest, is generally not sound regulatory practice.[7]

As Kroger witness Justin Bieber testified, there are some generally accepted criteria that can be used to determine the appropriateness of cost tracking and rider mechanisms:[8]

1) *The anticipated costs or revenues are subject to significant volatility from year to year,*
2) *The anticipated costs or revenues are not reasonably controllable by management, and*
3) *The anticipated costs or revenues are substantial enough to have a material impact on the utility's revenue requirement and financial health between rate cases.*

The proposed DCI Rider does not meet any of these three criteria. The DCI Rider as proposed in this case would include the Targeted Underground Program and serve as a placeholder for other programs that might be identified and approved by the Commission in the future. Based on the specific budget details for the Targeted Underground Program provided by Duke Witness Anthony Platz,[9] these costs do not appear to be volatile. Further, it is reasonable to expect that the Company should manage the costs associated with this program.[10]

Further, the DCI Rider would reduce the inherent incentive for Duke to manage its program costs. As explained by Attorney General witness Richard Baudino, Duke already has a process in place to prioritize and fund its distribution projects. Its current method has allowed the Company to invest and recover its costs (plus a rate of return) in its distribution system while providing reliable service to its customers. A DCI Rider is not needed. It would only serve to remove the Company's incentive to restrain its spending on distribution projects. Under a DCI Rider mechanism Duke would instead have a financial incentive to "*expand the universe of reliability projects to include those with lower priority and value*."[11] It is far more prudent to maintain the current course of recovering prudently incurred distribution expenses through the rate case process.

Kroger recommends that the Commission reject the proposed DCI Rider. The Targeted Underground Program costs proposed to be collected through this Rider amount to single-issue ratemaking and do not meet the

[7] Justin Bieber Direct, pages 12-13.
[8] Justin Bieber Direct, page 13.
[9] Anthony Platz Direct, page 29.
[10] Justin Bieber Direct, pages 13-14.
[11] Richard Baudino Direct, page 51.

generally accepted prerequisites for that kind of regulatory treatment. Further, it reduces the inherent incentive for Duke to manage its program costs.

3. <u>If The Commission Approves A Rate Increase That Is Significantly Less Than The $46.6 Million Originally Requested By Duke It Should Reduce Inter-Class Subsidies By An Amount Greater Than The 10 Percent Recommended By Duke.</u>

Through the testimony of its witness James Ziolkowski, Duke acknowledges that there are significant subsidies built into current rates and that "*developing rates that generate the amount of revenue that equals the allocated revenue requirement for each rate class will mean much greater increases for some rate classes, in terms of percentage increase, than other classes.*"[12] In order to reduce these subsidies and also mitigate the substantial rate increases to rate classes currently receiving subsidies, the Company proposes to eliminate 10 percent of the subsidy/excess revenues between customer classes based on present revenues.[13]

Kroger agrees with Duke's assertion that costs should be allocated on the basis of cost causation and that movement toward rate parity should be achieved in a manner that does not burden customer classes that are receiving a subsidy with unduly large rate increases. At Duke's originally proposed rate increase of $46.6 million, Duke recommends reducing the substantial subsidies between rate classes through a 10 percent subsidy reduction. This modest subsidy reduction may be a reasonable approach to avoiding "*rate shock*" if the Commission approves the full $46.6 million increase originally proposed by Duke. However, if the Commission approves a lower rate increase, then the rate increases to all classes will obviously be lower across the board. In that case a subsidy reduction greater than 10 percent can be implemented without burdening the subsidy-receiving rate classes with unduly high rate increases.

If the Commission authorizes a revenue requirement that includes further reductions to Duke's $46.6 million filed case and includes the effects of the lower corporate income tax rate, it creates more opportunity for Duke to lower rates for all rate classes. To the extent that there are additional reductions to the revenue

[12] James E. Ziolkowski Direct, page 26.
[13] James E. Ziolkowski Direct, page 26.

requirement, Kroger recommends that those reductions be used to reduce inter-class subsidy by an amount greater than 10 percent.

Respectfully submitted,

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