**COMMONWEALTH OF KENTUCKY**

**BEFORE THE**
**KENTUCKY PUBLIC SERVICE COMMISSION**

| | | |
|---|---|---|
| **In the Matter of 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** |

**Direct Testimony of Justin D. Bieber**

**on behalf of**

**The Kroger Co.**

**December 29, 2017**

**DIRECT TESTIMONY OF JUSTIN D. BIEBER**

**Q. Please state your name and business address.**

A. My name is Justin Bieber. My business address is 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

**Q. By whom are you employed and in what capacity?**

A. I am a Senior Consultant for Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

**Q. On whose behalf are you testifying in this proceeding?**

A. My testimony is being sponsored by The Kroger Co. (Kroger). Kroger is one of the largest retail grocers in the United States, and has over 50 accounts that are served by Duke Energy Kentucky, Inc. (DEK or the Company). Combined, Kroger facilities purchase over 50 million kWh annually from DEK.

**Q. Please describe your professional experience and qualifications.**

A. My academic background is in business and engineering. I earned a Bachelor of Science in Mechanical Engineering from Duke University in 2006 and a Master of Business Administration from the University of Southern California in 2012. Earlier this year I completed Practical Regulatory Training for the Electric Industry sponsored by the New Mexico State University Center for Public Utilities and the National Association of Regulatory Utility Commissioners. I am also a registered Professional Civil Engineer in the state of California.

I joined Energy Strategies in January 2017, where I provide regulatory and technical support on a variety of energy issues, including regulatory services, transmission and renewable development, and financial and economic analyses. During the time I have worked at Energy Strategies I have provided analytical support for the development of testimonies before several different state utility regulatory commissions.

Prior to joining Energy Strategies, I held positions at Pacific Gas and Electric Company as Manager of Transmission Project Development, ISO Relations and FERC Policy Principal, and Supervisor of Electric Generator Interconnections. During my career at Pacific Gas and Electric Company, I supported multiple facets of utility operations, and led efforts in policy, regulatory, and strategic initiatives, including support developing testimonies at the FERC, California ISO, and the California Public Utility Commission.

**Q. Have you testified previously before this Commission?**

**A.** No. This is my first opportunity to testify before the Kentucky Public Service Commission (Commission).

**Q. Have you filed testimony previously before any other state utility regulatory commissions?**

**A.** Yes. I have filed testimony before the North Carolina Utilities Commission and the Indiana Utility Regulatory Commission.

## Overview and Conclusions

**Q. What is the purpose of your testimony in this proceeding?**

A. My testimony addresses the following topics:

a) Recent tax reform changes that will impact DEK's federal tax obligations and revenue requirement,

b) Revenue allocation between rate schedules, and

c) DEK's proposed Distribution Capital Investment reconciliation mechanism (DCI rider).

**Q. Please summarize your recommendations to the Commission.**

A. The 2017 *Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018* (the "Tax Reform Act"), recently signed into law (PL 115-97), reduces the corporate tax rate from 35 percent to 21 percent. This directly decreases the Company's federal income tax expense for regulatory purposes, resulting in an approximate $10.6 million decrease to DEK's cost of service. The Company's revenue requirement in this case should be adjusted to reflect this direct impact to its cost of service. The decrease in the corporate income tax rate also decreases DEK's deferred tax liability resulting in a significant excess Accumulated Deferred Income Tax (ADIT) balance that should be returned to customers. I recommend that the Commission order DEK to prepare an excess ADIT amortization schedule through which excess ADIT will be credited to customers starting with the rate effective period in this general rate case, in a manner that is consistent with the requirements of the Tax Reform Act. Further, the Tax Reform Act makes changes to the tax code that may limit the Company's ability to take advantage of bonus tax depreciation going forward which may need to be taken into account in a compliance filing.

DEK's current rates contain significant interclass subsidies. DEK's proposed revenue allocation methodology that would reduce interclass subsidies by 10 percent does not make sufficient movement towards aligning rates with cost causation. The revenue requirement reduction resulting directly from the decreased corporate tax rate presents an opportunity to reduce DEK's proposed rates for *all* rate classes and reduce the interclass subsidies between rate classes. I recommend the Commission direct DEK to allocate half of the reduction in revenue requirement associated with the reduced corporate income tax rate to all rate classes and apply the rest of the reduction to reduce interclass subsidies.

I also recommend that the Commission reject DEK's requested DCI Rider. The requested rider amounts to single-issue ratemaking without consideration of whether the Company would experience offsetting decreases in expenses or increases in revenues. Further, it reduces the inherent incentive for DEK to minimize expenses and maximize revenues between general rate cases.

**<u>Tax Reform Act</u>**

**Q. Please explain how the reduction to the corporate tax rate from 35 percent to 21 percent directly reduces DEK's filed cost of service by approximately $10.6 million.**

A. The reduction in the corporate tax rate will reduce DEK'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 DEK's revenue requirement by approximately $10.6 million.

**Q. Are there additional impacts from the change in the tax rate?**

A. Yes. The change in the tax rate has significant implications for ADIT. DEK takes accelerated depreciation on certain assets for tax purposes that is greater than the amount of straight line depreciation that is taken on its regulatory books. This accelerated depreciation reduces the amount of income tax that DEK owes the federal government, relative to the income tax expense on its regulatory books. Therefore, customers pay income taxes in rates as if this accelerated depreciation did not exist. This difference between the amount of income tax that DEK owes the federal government and the amount of income tax that it collects from its customers through rates is the deferred income tax.

The deferred income taxes will ultimately have to be paid to the federal government at a later date. Until that time, customers are effectively providing DEK with a source of zero-cost capital. DEK 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,[1] DEK's anticipated future tax liability has also decreased by a comparable amount. As of January 1, 2018, when the new tax rates become effective, a substantial portion of the ADIT on DEK's books will be considered to be "excess" ADIT. This excess ADIT should be returned to customers.

[1] $1 - (21 \div 35) = 40\%$.

**Q. Over what period of time should the excess ADIT be returned to customers?**

A. The requirements regarding the amortization period to be used for returning excess ADIT to customers are set out in the Tax Reform Act. Generally, the amortization period must correspond to the remaining lives of the assets that gave rise to the ADIT balances. I recommend that the excess ADIT be returned to customers as quickly as possible, consistent with the requirements of the Tax Reform Act. The allowed rate of amortization for ADIT over the regulatory life of the assets will be gradual and should not cause financial hardship for the Company.

**Q. What is your recommendation with respect to the treatment of excess ADIT in this case?**

A. I recommend that the Commission order DEK to prepare an excess ADIT amortization schedule through which excess ADIT will be credited to customers starting with the rate effective period in this general rate case, in a manner that is consistent with the requirements of the Tax Reform Act. This crediting should continue until the excess ADIT is brought to zero. The scheduled credit in the test year should be incorporated into the revenue requirement in this case; alternatively, an appropriate rider mechanism for the credit should be established.

**Q. Does the reduced corporate tax rate have any other impacts on ADIT besides the creation of excess ADIT?**

A. Yes. As I describe above, the deferred income tax expense in the test year accumulates in the ADIT balance to reflect the future tax liability. If the deferred income tax expense decreases as result of a reduction in corporate tax rates, then the going-forward contribution to the ADIT balance will also decrease, all other things being equal. Since ADIT is a subtractive adjustment to rate base, decreasing the ADIT balance will increase the rate base. Normally, in isolation, reducing ADIT would produce an increase in revenue requirement. However, in DEK's filed case, the Company proposes to use jurisdictional electric capitalization, not rate base, as the basis for its return. If the Company's proposal to use capitalization is adopted, then the increase in rate base attributable to the reduced going-forward contribution to the ADIT (relative to DEK's filed case) may not impact the revenue requirement in this case.

**Q. Do you have any concerns with DEK's proposal to use its jurisdictional electric capitalization as the basis for computing its revenue requirement?**

A. Yes, I do. The jurisdictional electric capitalization presented by DEK is greater than the Company's rate base. As such, it represents a valuation that is in excess of the net value of assets that are used and useful in providing electric service to customers. I have serious concerns with allowing a return on a valuation that exceeds the net value of the assets that are used and useful for providing electric service to customers. However, I am not proposing a specific adjustment to DEK's revenue requirement for this item at this time in light of the anticipated changes to ADIT that will occur from the enactment of the Tax Reform Act.

**Q. What impact will the recent legislative changes to bonus tax depreciation rules have on DEK's cost of service?**

A. The Tax Reform Act appears to reduce the amount of accelerated depreciation that the Company is able to take in the test year relative to the filed case. A reduced amount of depreciation expense for tax purposes would result in a reduced ADIT balance relative to the filed case. The reduction in ADIT increases rate base by a comparable amount. However, if the Company's proposal to use capitalization is adopted, then the increase in rate base attributable to the elimination of bonus tax depreciation may not impact the revenue requirement in this case.

**Q. What is your recommendation regarding the impacts to the cost of service resulting from the Tax Reform Act?**

A. I recommend that the Commission order DEK to incorporate the direct impacts resulting from the reduction of the corporate tax rate from 35 percent to 21 percent in its filed case. The direct impact from the change in the corporate income tax is an approximate $10.6 million decrease to DEK's revenue requirement. In addition, the Commission should also require DEK to make other conforming adjustments to its revenue requirement to the extent necessary to reflect the new tax law.

Further, the Commission should order DEK to prepare an excess ADIT amortization schedule through which excess ADIT will be credited to customers, starting with the rate effective period in this general rate case. The excess ADIT should be returned to customers as quickly as it is allowed under the Tax Reform Act. The allowed rate of amortization for ADIT over the regulatory life of the assets will be gradual and should not cause financial hardship for the Company. This crediting should continue until the excess ADIT is brought to zero.

<u>**Revenue Allocation Between Rate Schedules**</u>

**Q. How does DEK allocate its proposed revenues among rate schedules?**

A. DEK Witness James Ziolkowski presents DEK's proposed revenue allocation in Workpaper FR-16(7)(v). DEK's proposed revenue increase is allocated to each rate schedule on the basis of jurisdictional electric capitalization, and then combined with an additional increase or decrease at the customer class level that results in a 10 percent reduction in each class's variance from the overall average rate of return. Mr. Ziolkowski recognizes that significant differences in the rates of return (ROR) exist for the various rate classes. In an effort to reduce these subsidies between rate classes while also invoking the principle of gradualism, Mr. Ziolkowski proposes to reduce the existing subsidies by 10 percent.[2]

**Q. What is your assessment of DEK's proposed revenue allocation?**

A. I generally believe that costs should be allocated on the basis of cost causation and support a gradual reduction in subsidies that bring rate classes closer to parity. In this case, substantial subsidies exist between rate classes. The amount of the subsidy currently being paid by each rate class is shown in Table JDB-1 below. While the 10 percent reduction in subsidies proposed by DEK represents movement in the right direction, it does not make sufficient movement towards aligning rates with cost causation. Fortunately, the recent change to the corporate tax rate and the corresponding reduction to the revenue requirement

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[2] James E. Ziolkowski Direct, pp. 28.

provide an opportunity to decrease the proposed revenues for all rate classes while also further reducing the subsidies between rate classes.

**Q. How do you recommend that the proposed revenue allocation be adjusted to incorporate the revenue requirement reduction resulting from the reduced corporate tax rate?**

A. I recommend that 50 percent of the corporate tax rate revenue requirement reduction should be used to reduce DEK's proposed class revenues for *all* rate classes. This decrease should be allocated on a pro rata basis proportional to each class's jurisdictional electric capitalization. This is consistent with DEK's method of allocating its proposed revenue increase.

The remaining 50 percent of the corporate tax rate revenue requirement reduction should be used to further reduce interclass subsidies. This amount should be allocated to the subsidy-paying classes on a pro rata basis in proportion to the amount of the subsidy each class is currently paying in its present rates.

My recommended adjustment ensures that proposed revenues are reduced for all rate classes compared to DEK's filed case. Table JDB-1 below illustrates the current subsidies being paid by each rate class as well as DEK's proposed revenues and my recommended adjustments. A negative subsidy means that a rate class is receiving the benefit of the subsidy while a positive subsidy means that a rate class is a subsidy provider.

## Table JDB -1

### Comparison of Current Subsidies to DEK Proposed and Adjusted Revenue Allocation

| | Current Interclass Subsidy Paid (Received) | DEK Proposed Revenues | Adjusted Increase After Tax Rate RR Reduction | Kroger Proposed Tax Rate RR Reduction To Filed Case |
|---|---|---|---|---|
| Rate RS | $ (9,536,688) | $ 143,246,041 | $ 140,861,303 | -1.66% |
| Rate DS | $ 8,940,522 | $ 102,925,025 | $ 97,273,311 | -5.49% |
| Rate GS-FL | $ 167,973 | $ 637,510 | $ 552,661 | -13.31% |
| Rate EH | $ (839,738) | $ 947,233 | $ 921,143 | -2.75% |
| Rate SP | $ 5,970 | $ 32,073 | $ 28,877 | -9.96% |
| Rate DT - Secondary | $ 1,973,352 | $ 52,045,767 | $ 50,440,943 | -3.08% |
| Rate DT-Primary | $ (704,376) | $ 35,131,912 | $ 34,659,414 | -1.34% |
| Rate DP | $ (107,840) | $ 1,094,414 | $ 1,077,332 | -1.56% |
| Rate TT | $ 341,432 | $ 14,686,131 | $ 14,364,591 | -2.19% |
| Lighting | $ (83,088) | $ 2,112,057 | $ 2,088,714 | -1.11% |
| Other - Water Pumping | $ (157,519) | $ 58,629 | $ 54,765 | -6.59% |
| Total | $ - | $ 352,916,793 | $ 342,323,054 | -3.00% |

**Q. If the Commission authorizes a revenue requirement that includes other reductions, in addition to the corporate tax reduction, how does that impact your recommendation?**

A. If the Commission authorizes a revenue requirement that includes further reductions to DEK's filed case, that creates more opportunity for DEK to lower proposed rates for all rate classes. To the extent that there are additional reductions to the revenue requirement, I recommend that those reductions be used to further reduce the class revenue requirement for all rate classes on a pro rata basis proportional to each class's jurisdictional electric capitalization.

**<u>Distribution Capital Investment Reconciliation Mechanism (DCI Rider)</u>**

**Q. Please describe the Company's DCI rider proposal.**

A. DEK is proposing the DCI rider as a rider 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, DEK is proposing to include the Targeted Underground Program in the DCI rider. The Company will propose new programs to be included in the rider for Commission review in the future as challenges and solutions are identified.[3] The Company's intent for Rider DCI is to allow the Company to identify and proactively address reliability and integrity issues through a coordinated and targeted strategy.[4]

**Q. What is your assessment of the Company's DCI rider proposal?**

A. The Company's DCI rider proposal amounts to single-issue ratemaking and reduces the Company's incentive to manage its costs effectively.

**Q. What is single-issue ratemaking?**

A. 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.

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

[3] Anthony Platz Direct, pp. 25.
[4] *Id*, pp. 31.

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

**Q. Are there certain prerequisites that should be met to warrant the adoption of a cost tracking rider such as the DCI rider?**

A. There are some generally accepted criteria that can be used to determine the appropriateness of cost tracking and rider mechanisms:

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.

**Q. Does DEK's proposed DCI rider meet these three criteria?**

A. No, it does not. 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 DEK Witness Anthony Platz,[5] 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.

**Q. What do you recommend with respect to the DCI rider proposal?**

A. I recommend 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 generally accepted prerequisites for that kind of regulatory treatment. Further, it reduces the inherent incentive for DEK to manage the program costs.

DEK also proposes to use the DCI rider as a mechanism to include the costs of other programs that might be identified in the future in order to maintain the safety, reliability, and integrity of its delivery system. Investing in and maintaining the safety, reliability, and integrity of the distribution system are fundamental responsibilities for a utility company. In carrying out this responsibility, utilities are entitled to an opportunity to recover their prudently-incurred costs. Rather than relying on expanded cost recovery under a new rider, any incremental distribution costs should be considered in the context of a general rate case.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.

[5] Anthony Platz Direct, pp. 29.

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| **In the Matter of 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** |

AFFIDAVIT OF JUSTIN D. BIEBER

STATE OF UTAH )
COUNTY OF SALT LAKE )

Justin D. Bieber, being first duly sworn, deposes and states that:

1. He is a Senior Consultant with Energy Strategies, L.L.C., in Salt Lake City, Utah;

2. He is the witness who sponsors the accompanying testimony entitled "Direct Testimony of Justin D. Bieber;"

3. Said testimony and exhibits were prepared by him and under his direction and supervision;

4. If inquiries were made as to the facts in said testimony and exhibits he would respond as therein set forth; and

5. The aforesaid testimony is true and correct to the best of his knowledge, information and belief.

Justin D. Bieber

Subscribed and sworn to or affirmed before me this 28th day of December, 2017, by Justin D. Bieber.

Millicent Pichardo
Notary Public

Notary Public
MILLICENT PICHARDO
Commission #676080
My Commission Expires
June 6, 2018
State of Utah

## Revenue Allocation Adjustment
## Resulting from Reduced Corporate Tax Rate Revenue Requirement Impact

| | Current Inter Class Subsidization Paid/ (Received) | Inter Class Subsidization Paid/ (Received) % of Present Rev | DEK Proposed Revenues (Includes 10% Subsidy Reduction) | DEK Proposed Percentage Increase | Apply 50% of RR Reduction To All Classes | Apply 50% of RR Reduction To Subsidies | Adjusted Revenues After Tax Rate RR Reduction | Adjusted Increase After Tax Rate RR Reduction | Kroger Proposed Tax Rate RR Reduction To Filed Case |
|---|---|---|---|---|---|---|---|---|---|
| Rate RS | $ (9,536,688) | -7.92% | $ 143,246,041 | 18.98% | $ (2,384,738.44) | $ - | $ 140,861,303 | 17.00% | -1.66% |
| Rate DS | $ 8,940,522 | 9.94% | $ 102,925,025 | 14.40% | $ (1,508,240.92) | $ (4,143,472.44) | $ 97,273,311 | 8.12% | -5.49% |
| Rate GS-FL | $ 167,973 | 28.47% | $ 637,510 | 8.05% | $ (7,002.46) | $ (77,846.85) | $ 552,661 | -6.33% | -13.31% |
| Rate EH | $ (839,738) | -134.65% | $ 947,233 | 51.89% | $ (26,090.56) | $ - | $ 921,143 | 47.71% | -2.75% |
| Rate SP | $ 5,970 | 20.78% | $ 32,073 | 11.64% | $ (429.26) | $ (2,766.79) | $ 28,877 | 0.51% | -9.96% |
| Rate DT - Secondary | $ 1,973,352 | 4.30% | $ 52,045,767 | 13.38% | $ (690,277.57) | $ (914,547.23) | $ 50,440,943 | 9.88% | -3.08% |
| Rate DT-Primary | $ (704,376) | -2.29% | $ 35,131,912 | 14.35% | $ (472,497.98) | $ - | $ 34,659,414 | 12.82% | -1.34% |
| Rate DP | $ (107,840) | -11.64% | $ 1,094,414 | 18.09% | $ (17,081.71) | $ - | $ 1,077,332 | 16.25% | -1.56% |
| Rate TT | $ 341,432 | 2.58% | $ 14,686,131 | 11.09% | $ (163,304.11) | $ (158,236.18) | $ 14,364,591 | 8.65% | -2.19% |
| Lighting | $ (83,088) | -4.40% | $ 2,112,057 | 11.79% | $ (23,342.73) | $ - | $ 2,088,714 | 10.55% | -1.11% |
| Other - Water Pumping | $ (157,519) | -2124.62% | $ 58,629 | 690.79% | $ (3,863.75) | $ - | $ 54,765 | 638.67% | -6.59% |
| Total | $ - | | $ 352,916,793 | 15.99% | $ (5,296,870) | $ (5,296,870) | $ 342,323,054 | 12.51% | -3.00% |