COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.	)	
	)	
V.	)	Case No. 2017-00477
	)	
KENTUCKY UTILITIES COMPANY, LOUISVILLE GAS AND ELECTRIC COMPANY, KENTUCKY POWER COMPANY AND DUKE ENERGY KENTUCKY, INC.	)	

DIRECT TESTIMONY OF

WILLIAM DON WATHEN JR.

ON BEHALF OF

DUKE ENERGY KENTUCKY, INC.

January 26, 2018

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William Don Wathen Jr., and my business address is 139 East Fourth Street, Cincinnati, Ohio 45202.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Duke Energy Business Services LLC (DEBS), as Director of Rates and Regulatory Strategy for Ohio and Kentucky. DEBS provides various administrative and other services to Duke Energy Kentucky, Inc., (Duke Energy Kentucky or Company) and other affiliated companies of Duke Energy Corporation (Duke Energy).

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A. I received Bachelor Degrees in Business and Chemical Engineering, and a Master of Business Administration Degree, all from the University of Kentucky. After completing graduate studies, I was employed by Kentucky Utilities Company as a planning analyst. In 1989, I began employment with the Indiana Utility Regulatory Commission as a senior engineer. From 1992 until mid-1998, I was employed by SVBK Consulting Group, where I held several positions as a consultant, focusing principally on utility rate matters. I was hired by Duke Energy (then Cinergy Services, Inc.), in 1998, as an Economic and Financial Specialist in the Budgets and Forecasts Department. In 1999, I was promoted to the position of Manager, Financial Forecasts. In August 2003, I was named to the position of Director - Rates. On December 1, 2009, I took the position of General Manager and Vice President of

Rates, Ohio and Kentucky. On July 3, 2012, as a result of the merger between Duke Energy and Progress Energy Corp., my title changed to Director of Rates and Regulatory Strategy for Ohio and Kentucky.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS DIRECTOR OF RATES AND REGULATORY STRATEGY FOR OHIO AND KENTUCKY.

A. As Director of Rates and Regulatory Strategy for Ohio and Kentucky, I am responsible for all state and federal rate matters involving Duke Energy Kentucky and its parent, Duke Energy Ohio, Inc.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION?

A. Yes. I have previously testified in a number of cases before the Kentucky Public Service Commission (Commission) and other regulatory commissions.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?

A. My testimony is in response to the January 5, 2018, Order issued by the Kentucky Public Service Commission (Commission) to provide testimony in support of the Company's position regarding the substance of the Complaint filed in this proceeding on December 21, 2017. My testimony addresses the impact of the Tax Act on the Company's electric and its natural gas operations. I make proposals for both service types designed to ensure that customers start receiving benefits of the Tax Act in a manner that is reasonable and fair to both customers and the Company and as expeditiously as possible.

II. IMPACT OF THE TAX ACT

Q. PLEASE BRIEFLY DESCRIBE THE TAX ACT AND ITS MOST SIGNIFICANT CHANGES.

A. On December 22, 2017, the President signed the Tax Act into law. The stated purpose behind the Tax Act is to stimulate business investments and grow the economy. For better or worse, the provisions of the Tax Act will affect all U.S. citizens and corporations. As a regulated utility with electric and gas service, Duke Energy Kentucky is affected by these key provisions of the Tax Act: (1) reduction of the corporate tax rate from 35 percent to 21 percent; (2) retention of interest deductibility; and (3) elimination of bonus depreciation. The Tax Act also provides guidance on the treatment of excess accumulated deferred income taxes (ADITs) resulting from the Act. Company witness Stephen G. De May provides a detailed description of these and other provisions of the Tax Act, including the treatment of these deferred taxes.

The changes enacted are effective beginning January 1, 2018, but will have some impact on calendar year 2017 as well, to the extent the Company will have to make journal entries on its books to reflect the changes that begin in 2018. The Company recorded a regulatory liability on December 31, 2017, to reflect the estimated excess ADITs as of that date. The estimated excess ADITs will be deferred until the Commission determines the methodology and timing for returning such benefits to customers, subject to the normalization requirements included in the Tax Act. The estimated excess ADITs will be adjusted as more detailed analysis of the Tax Act and its impact to the Company is performed in

2018. For its regulated operations, the 2017 journal entries have no impact on the Company's cost of service. The ultimate impacts for future years, including 2018, will only be apparent as we move through time but, at this time, the Company can only estimate the financial impacts at of the Tax Act.

Q. PLEASE SUMMARIZE HOW THE TAX ACT COULD IMPACT DUKE ENERGY KENTUCKY AND ITS CUSTOMERS.

A. Duke Energy Kentucky witness De May describes these changes in great detail in his testimony. By any measure, the effect of the Tax Act on regulated utilities is very complex and the full extent of its implications are still being considered and analyzed. The most conspicuous impact of the Tax Act for corporations, including regulated utilities, is the 40 percent reduction in the federal tax rate.[1] The reduction in the federal income tax rate also creates the excess ADITs I mentioned above. The excess ADITs represent amounts collected from customers that will no longer be paid to taxing authorities in the future as a result of the tax rate reduction. These are two elements of the Tax Act that will provide downward pressure on utility rates; however, the lower income tax rate and other elements of the Tax Act will serve to offset these benefits. These changes include how capital is expensed and depreciated for tax purposes under the Tax Act (*i.e.,* elimination of 'bonus' depreciation) and the elimination of the manufacturing deduction, both of which previously served to reduce the amount by which rate base is financed. Mr. De May discusses these items in his testimony.

Q. PLEASE EXPLAIN HOW THE TAX ACT AFFECTS DUKE ENERGY KENTUCKY'S RATES.

[1] (0.35-0.21)/0.35= 0.40 or 40%

A. At a high level, the implications of the Tax Act on customers' rates can be distilled into three distinct categories.

(1) Reduction in the federal income tax rate from 35 percent to 21 percent reduces the utilities' tax expense in a given year.

(2) Accounting and rate treatment of excess ADITs as of December 31, 2017, subject to normalization rules and Commission approval.

(3) Rate base will be higher in future rate proceedings due to the elimination of bonus deprecation and the reduced value of accelerated depreciation due to the lower federal income tax rate.

The 40 percent reduction in the federal corporate tax rate that went into effect in January 2018 means that the taxes currently collected in rates are not reflective of the tax obligation that the Company will have going forward. In other words, for the utility to earn a dollar of net income (*i.e.*, shareholders' return on their investment), it would generally take \$1.54 in revenue from customers at a federal tax rate of 35 percent. \$0.54 of the revenue is for federal income taxes leaving the \$1.00 for shareholders. At a federal tax rate of 21 percent, only about \$1.27 of revenue from customers is needed to produce the same level of net income. Converting net income to a revenue requirement is normally done by using a gross revenue conversion factor (GRCF), which is calculated a 1 ÷ (1-T), where "T" is the tax rate. In this formula, it is evident that the lower the value for "T," the lower the GRCF will be. There are some slight differences due to the deductibility of state taxes but the math is essentially the same.

Duke Energy Kentucky's current base rates for electric and gas operations were filed in 2006 and 2009, respectively.[2] Both of those cases included a level of federal taxes to be paid during the test year in the cases based upon the then-current 35 percent tax rate. The change in the rate to 21 percent means that, beginning with tax year 2018, Duke Energy Kentucky's tax obligation will be reduced. However, that does not necessarily mean the Company is earning an unreasonable return on its investment. In any given year, some components of the Company's cost of service may increase and other components may decrease. Because of the Tax Act, the Company's income tax expense will decrease beginning in 2018 but the combination of all other elements of the cost of service may indicate that the Company's current rates are still insufficient to be just, reasonable, and fair, let alone reach a level that can be considered as generating excessive earnings.

As it relates to excess ADITs that are to be flowed back to customers, the value of this benefit will be reflected in the Company's rates in one form or another over time and consistent with normalization rules and Commission approvals. The normalization rules will dictate the timing of when customers receive the benefit of the 'protected' excess ADITs and the Commission will determine how and when customers receive the benefit of 'unprotected' excess ADITs. As explained by Mr. De May, "protected" excess ADITs are those that derive from higher tax depreciation than book depreciation for utility property. The amortization of protected excess ADITs is dictated by normalization rules.

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[2] *In the Matter of the Application of the Union Light, Heat and Power Company D/B/A/ Duke Energy Kentucky for an Adjustment of Electric Rates,* Case No. 2006-00172 (Ky. P.S.C. December 21, 2006); and *In the Matter of the Application of Duke Energy Kentucky, Inc., for an Adjustment of Rates,* Case No. 2009-00202 (Ky. P.S.C. December 29, 2009).

"Unprotected" excess ADITs represents the remainder of the excess ADIT balance and returning the benefit of these excess ADITs is generally left up to the Commission for its determination.

Lastly, the Tax Act contains other provisions that partially offset the benefits of the tax rate reduction. The loss of bonus depreciation along with the lower income tax rate reduces the benefit customers receive in the form of using any accelerated depreciation for calculating income tax expense. This will, in turn, cause upward pressure on the utility rate base (increasing from what it otherwise would have been) over time. Absent bonus depreciation, the taxable basis of new property placed into service will be higher, meaning rate base will also be higher and will grow at a quicker pace than before the Tax Act was effective.

Q. HAS DUKE ENERGY KENTUCKY QUANTIFIED THE INITIAL IMPACT OF THE TAX ACT?

A. Yes. Tbe Company has estimated the impact of the Tax Act as it relates to the change in the GRCF for both its electric and its gas rates. The Company is still evaluating and measuring its excess ADITs and is also sorting out the "protected" excess ADITS from the "unprotected" excess ADITs.

III. IMPACT OF TAX ACT ON DUKE ENERGY KENTUCKY'S ELECTRIC AND NATURAL GAS RATES

Q. WHAT IS THE ESTIMATED IMPACT OF THE TAX ACT ON DUKE ENERGY KENTUCKY'S ELECTRIC AND NATURAL GAS BASE RATES AS IT RELATES TO THE LOWER GROSS REVENUE CONVERSION FACTOR?

A. The test year revenue requirement used to establish the existing base rates for electric and gas base rates assumed a federal income tax rate was 35 percent. If the federal tax rate underlying the current base rates had instead been 21 percent, the forecasted test year revenue requirement, for calendar 2007, in Company's last electric rate case would have been approximately $8.3 million lower than what was approved in Case No. 2006-00172.

If the federal tax rate underlying the current base rates had instead been 21 percent, the forecasted test year revenue requirement, for the twelve months ending January 31, 2011, in Company's last gas rate case would bave been approximately $3.1 million lower than what was approved in Case No. 2009-00202.

Q. WHY ARE YOU CALCULATING THE IMPACT BASED ON THE LAST RATE CASES RATHER THAN WHAT THE COMPANY ACTUALLY PAYS FOR FEDERAL INCOME TAXES?

A. The question at hand is limited to the impact of the tax change on customers' base rates. Customers' existing rates include, among many other items, a component for federal income taxes. This component of the revenue requirement, like all other components included in the Company's rate case, was based on circumstances that existed at the time those base rates were established. It is only the amount included in the base rates for income taxes that customers are actually paying. Therefore, I recalculated the revenue requirement underlying the existing base rates for electric and gas service assuming that the revenue requirement was based on a federal income tax rate of 21 percent rather than the 35 percent that existed at the time. This obviously ignores changes in ALL other costs and ignores any incremental investments made by the Company since that time but it does parse the existing base rates for the single issue of the change in the federal income tax rate.

Q. SHOULD THE COMMISSION LIMIT ITS FOCUS ON ONLY THE CHANGE IN THE FEDERAL INCOME TAX RATE?

A. Ordinarily, a utility such as Duke Energy Kentucky, will seek to adjust its rates if the sum of its costs, including a fair rate of return, exceeds its revenue. Since the time existing electric and natural gas base rates were established pursuant to Commission approval, circumstances change with some costs going up and some costs going down. The most conspicuous example is the changes resulting from the Tax Act; however, due to other factors, Duke Energy Kentucky's overall revenue is still not projected to earn a reasonable rate of return for 2018, even with the lower federal income tax rate.

Q. WHY IS IT IMPORTANT TO CONSIDER THE CHANGES IN THE TAX ACT IN LIGHT OF OTHER INVESTMENTS AND CHANGES IN THE COMPANY'S EXPENSES SINCE THE COMPANY'S LAST ELECTRIC AND NATURAL GAS RATE PROCEEDINGS?

A. At the heart of this complaint case is an unsubstantiated allegation that, due to the Tax Act and the 40 percent reduction in the federal corporate tax rate coupled with the creation of the excess ADITs, Duke Energy Kentucky's rates have become excessive (*i.e.*, too high), and therefore, "will no longer be fair, just, and reasonable beginning on January 1, 2018."[3] The Company disputes this allegation. The only way the Company's rates can be considered excessive, is if the Company is earning, beginning January 1, 2018, in excess of a fair, just, and reasonable rate of return.

Q. ARE DUKE ENERGY KENTUCKY'S CURRENT ELECTRIC RATES EXCESSIVE AS A RESULT OF THE CHANGES FROM THE TAX ACT?

A. No. Based on the Company's rate analysis in its September 1, 2017, rate application filing, the Company's electric operations were projected to earn a return on capitalization of only 2.850 percent for the forecasted test period spanning the twelve months ending March 31, 2019,[4] based on the 35 percent federal tax rate assumed at the time of the filing. Even at the lower 21 percent federal income tax rate, the Company's projected return on electric capitalization for the test year would only be 3.061 percent. It is difficult for anyone to make a colorable argument that the Company's projected electric rate of return, at 3.061 percent through March 31, 2019, is excessive, even when one factors in the improving the Company's earnings for that period from the reduction of tax expense under the Tax Act.

Q. ARE THE COMPANY'S CURRENT NATURAL GAS RATES EXCESSIVE DUE TO THE CHANGES UNDER THE TAX ACT?

A. No. Based on the Company's financial projections for 2018, even if it retained the

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[3] Complaint at 2.

[4] *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, Application at 6 (Ky. P.S.C. September 1, 2017).

benefit of the lower federal income tax, its current natural gas base rates are expected to be insufficient to allow the Company to fully recover its costs of service meaning the Company will not be earning a fair, just, and reasonable return. The Company's projected revenue for 2018, at existing rates, when netted against its projected expenses (reduced for the change in the federal income tax rate), for the same period, is expected to generate a return on equity of approximately 6.53 percent. If the Company's rates are adjusted only for the change in the federal income tax rate, the Company's estimated return on equity falls even further to 5.29 percent for 2018. Importantly, for 2018, the Company is expected to earn a return on equity significantly below the 10.375 percent return on equity approved in the Company's last natural gas base rate case, Case No. 2009-00202.[5] Furthermore, the Company's expected 2018 earnings, with or without the benefit of the lower federal income tax rate is significantly lower than any return on equity the Commission has deemed fair, just, and reasonahle in recent memory.

Q. IF DUKE ENERGY KENTUCKY'S CURRENT NATURAL GAS RATES ARE INSUFFICIENT TO RECOVER THE COMPANY'S COSTS AND PROVIDE AN OPPORTUNITY TO EARN A REASONABLE RETURN, WHY HASN'T THE COMPANY FILED A NATURAL GAS BASE RATE CASE?

A. The Company's financial condition and returns provided through rates are not static and change over time as the Company's costs increase or decrease, load

[5] *In the Matter of the Application of Duke Energy Kentucky, Inc., for an Adjustment of Rates,* Case No. 2009-00202 (Ky. P.S.C. December 29, 2009 at 4); approving the stipulated return on equity of 10.375 percent.

changes, energy efficiency participation fluctuates, and even weather patterns change. Layering on top of that, are regulatory commitments and decisions that also impact the timing and filing of rate increases. For example, since 2009, multiple intervening events have impacted the Company's ability to file rate cases through negotiated stay-outs, and balancing the timing of other rate increases to its customers. As part of the settlement of Case No. 2009-00202, Duke Energy Kentucky agreed to an eighteen-month natural gas base rate case stay-out.[6] Then, by Order dated October 28, 2011, as part of the settlement in Case No. 2011-00124, the parties to that case negotiated and the Commission approved a two-year electric and natural gas base rate case stay-out.[7] Then on February 2, 2016, in Case No. 2015-00210, the Commission approved a settlement that included a one-year base rate case stay-out for natural gas rates.[8] While the term of the most recent natural gas rate case stay out expired in early 2017, the Company elected to not pursue a natural gas rate case in 2017 knowing that there was a present and immediate need for the Company to file an electric base rate case in 2017. Traditionally, the Company has not filed combined electric and natural gas cases so that its combination customers are not overburdened with overlapping natural gas and electric rate increases. The vast majority of Duke Energy Kentucky's

[6] *In the Matter of the Application of Duke Energy Kentucky, Inc., for an Adjustment of Rates*, Case No. 2009-00202 (Ky.P.S.C. December 29, 2009 at 3); *agreeing not to file an application to increase its natural gas base rates for eighteen months.*

[7] *In the Matter of the Joint Application of Duke Energy Corporation, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., Diamond Acquisition Corporation, and Progress Energy, Inc. for Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.*, Case No. 2011-00124 (Ky.P.S.C. October 28, 2011 at pg. 3); *agreeing to a two-year moratorium on filing new electric or gas base rate applications.*

[8] *In the Matter of the Application of Duke Energy Kentucky, Inc. For a Certificate of Public Convenience and Necessity Authorizing the Implementation of an Accelerated Service Line Replacement Program, Approval of Ownership of Service Lines, and a Gas Pipeline Replacement Surcharge,* Case No. 2015-00210 (Ky.P.S.C. February 2, 2016 at 3); *agreeing not to file an application to increase its natural gas base rates for one year.*

natural gas customers are also Duke Energy Kentucky electric customers. Keeping these rate increases discrete and separate is a service to customers so as not to impact both winter heating and summer cooling costs at the same time.

Q. DOES THE COMPANY HAVE AN ESTIMATE OF THE VALUE OF THE EXCESS ADITS FOR ELECTRIC AND NATURAL GAS AT THIS TIME?

A. As noted above, the balance of the excess ADITs are estimates at this point and will be adjusted as the data is refined. With that caveat, the Company has computed high-level estimates of the total excess ADIT balances to be approximately $68.0 million for electric and $31.7 million for gas. The Company is continuing to review and analyze its regulatory accounts to determine an accurate assessment and quantification of the protected and unprotected ADIT balances and will provide additional information as it becomes available.

The Company does not dispute that the value of the excess ADITs should be returned to customers; however, the Company proposes that the Commission complete its review of the Tax Act and explore alternatives for flowing back the benefits before directing that refunds should be made. Customers are unharmed inasmuch as the full value will still be returned in a manner that is consistent with the Tax Act's requirements.

Q. ARE YOU SUGGESTING THAT DUKE ENERGY KENTUCKY'S CUSTOMERS SHOULD NOT BENEFIT FROM THE CHANGES IN THE COMPANY'S COST TO SERVE AS A RESULT OF THE TAX ACT?

A. Not at all. Customers should benefit, but conversely, utilities should not be harmed by the Commission's actions in relation to the passage of the Tax Act. In order to strike this balance, all impacts of the Tax Act must be considered. Most importantly, the Commission needs to ensure that customers receive and the utility is providing reasonable service at reasonable rates. However, adjusting utility rates solely to account for the impact of the reduction in the federal corporate tax rate and the excess ADITs without any regard to all other implications of the Tax Act, not to mention other costs impacting the financial condition of the utility, is itself, unreasonable. Again, that is not to say customers should not benefit from this change in law. They should. The reduction in the federal tax rate, however does not automatically equate to the utility's current rates becoming excessive or unreasonable. While it may be appropriate for the Commission to consider whether a regulated utility's existing rates charged to its customers are potentially "excessive," given that certain costs (namely federal taxes) will be reduced the overall guiding principle is, and should continue to be, whether the regulated utility's rates as a whole, given all changes that may have occurred since those rates were last set, remain "just and reasonable." If, upon examination of all facts and circumstances impacting the utility, the Commission determines that the Company's rates are excessive or unreasonable, then the rates should be adjusted. The Mission Statement for the Commission acknowledges the importance of this balance.

> *"The mission of the Kentucky Public Service Commission is to foster the provision of safe and reliable service at a reasonable price to the customers of jurisdictional utilities while providing for the financial stability of those utilities by setting fair and just rates, and supporting their operational competence by overseeing regulated activities."*[9]

[9] https://www.psc.ky.gov/Home/About#AbtComm

As I discuss below, Duke Energy Kentucky is making a proposal that will both balance the need for a utility to maintain its financial integrity and to provide customers with the ability to receive benefits of the utility's immediate reduction in its short-term costs of service under the Tax Act.

IV. <u>DUKE ENERGY KENTUCKY'S OFFER OF SATISFACTION</u>

A. Electric Operations

Q. PLEASE DESCRIBE DUKE ENERGY KENTUCKY'S OFFER OF SATISFACTION FOR ITS ELECTRIC OPERATIONS.

A. As the Commission is aware, the Company currently has an electric base rate proceeding, Case No. 2017-00321, pending before it that seeks a base revenue increase of approximately $48.6 million using a forecasted test year that consists of the twelve-month period ending March 31, 2019.[10] As such, Duke Energy Kentucky is proposing that the impact of the Tax Act be addressed in that case, not this complaint proceeding. Intervenors in the pending electric rate case have raised the Tax Act as an issue and it would be a reasonable solution to address the changes in the Company's electric rates through its currently pending electric base rate case. In this manner, the impact of the Tax Act, along with all other components of the Company's overall revenue requirement can be addressed holistically. The Commission's decision in that proceeding, including consideration of the Tax Act, would reflect its assessment of a 'fair, just, and

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[10] *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, Application at 6 (Ky. P.S.C. September 1, 2017).

reasonable' return for Duke Energy Kentucky's electric operations.

Q. WOULD CUSTOMERS BE HARMED BY RESOLVING THE IMPLICATIONS OF THE TAX ACT ON ELECTRIC RATES IF ADDRESSED IN THE RATE CASE AS OPPOSED TO THIS COMPLAINT PROCEEDING?

A. As discussed above, rates for Duke Energy Kentucky's electric service (and its natural gas service) should be fair, just, and reasonable as determined by the Commission. Normally, the Commission's determination is made as a result of a rate case proceeding. So, the allegation raised in the KIUC complaint that the Company's electric rates are not "fair, just, and reasonable" beginning January 1, 2018, warrants a review of the Company's financial condition to determine whether the allegation is true.

Coincidentally, Duke Energy Kentucky's pending electric rate case was filed specifically for the purpose of determining whether its current electric base rates provides a fair, just, and reasonable return for the period April 1, 2018, through March 31, 2019. It is the Company's expectation that, beginning with the effective date of new electric base rates approved by the Commission, customers will benefit from the lower federal income tax rate as the Tax Act will serve to mitigate a portion of the overall increase in base rates. For example, if the Commission approves the Company's application, as filed, but lowers the overall revenue requirement to reflect the lower federal income tax rate, it is projected that base revenues would still need to increase by approximately $38 million to meet the Company's overall revenue requirement. The lower federal income tax rate reduces the Company's overall revenue requirement by about $10.6 million[11] from the $48.6 million based on the 35 percent federal income tax rate.

Importantly, no party interested in the impact of the Tax Act on Duke Energy Kentucky will be prejudiced by addressing the Tax Act issues in the electric rate case. The Attorney General and the KIUC are both parties to the Company's rate case. Moreover, the issue of the impact of the Tax Act has already been brought up in that rate case through the direct testimony of the Attorney General's witness, Lane Kollen. Therefore, the Commission has testimony from Mr. Kollen regarding his estimates of the Tax Act's impact on Duke Energy Kentucky's overall revenue requirement in the base rate case. Mr. Kollen also provided calculations as part of the initial complaint in this case. In both cases, Mr. Kollen's estimates are, either inaccurate or based on overly simplistic assumptions.

With respect to the estimated excess ADITs for electric operations as depicted above in my testimony, Mr. Kollen aggressively assumed a twenty-year amortization of ALL excess ADITs. Even if his calculation was accurate, which it is not, the impact on the revenue requirement still does not offset the Company's need for an increase in base revenue. Therefore, incorporating the Tax Act implications in the Company's electric rate case will allow the Company to only adjust its rates once and include the impact of all factors influencing its revenue requirement through one set of tariffs filed at the conclusion of the rate case rather than multiple times as a result of multiple proceedings. This will eliminate

[11] The estimated impact on the Company's overall revenue requirement from Case No. 2017-00321 from changing the federal income tax rate from 35 percent to 21 percent.

customer confusion, unnecessary costs of preparing, printing, and publishing new tariffed rates multiple times in the span of only a couple of months.

Additionally, with the suspension period of the Company's electric rate case approaching in April 2018, and assuming the Commission issues its Order prior to that date, the electric rate case could potentially afford an opportunity for Duke Energy Kentucky's electric customers to have resolution of the issue faster than what is likely to occur through this Complaint proceeding if due process is afforded, discovery is had, evidentiary hearings are scheduled and notices are to be published.

Q. WILL THE COMPANY BE INCORPORATING ITS PROPOSAL FOR ADDRESSING THE TAX ACT WHEN IT FILES ITS REBUTTAL TESTIMONY?

A. Yes. In addition to responding to the testimony of the various intervenors in the proceeding, the Company will be proposing adjustments to its test year revenue requirement to reflect the impact of the Tax Act.

B. Natural Gas Operations

Q. PLEASE DESCRIBE DUKE ENERGY KENTUCKY'S OFFER OF SATISFACTION FOR ITS NATURAL GAS OPERATIONS.

A. The Company is in a slightly different position with respect to its natural gas operations. Duke Energy Kentucky has not filed an application for a natural gas base rate increase since 2009. The Company's natural gas rates, prior to the passage of the Tax Act, and now after its implementation, do not change the fact that the Company is not recovering its reasonable costs incurred in providing service, nor is it afforded an opportunity to earn a reasonable return. Therefore, to balance the desire to have customers receive an immediate benefit and the Company's interest in maintaining financial integrity, Duke Energy Kentucky is proposing to implement a rider effective April 1, 2018, that will begin crediting back customers any earnings as a result in the change in the Tax Act that causes the Company's natural gas operations to earn in excess of 9.7 percent, the return on equity authorized by the Commission in the Company's Accelerated Service Line Replacement Program. This 9.7 percent return on equity is significantly lower than the 10.375 percent return on equity that was authorized by the Commission in the Company's 2009 natural gas rate case proceeding. In addition, Duke Energy Kentucky commits to filing a natural gas base rate case no later than December 1, 2018, where the full impacts of the Tax Act will be considered and evaluated by the Commission.

Q. PLEASE EXPLAIN HOW THIS MECHANISM WILL OPERATE?

A. Duke Energy Kentucky proposes to implement a Tax Act earnings tracking mechanism (Rider TA) that will be designed to provide a bill credit to its natural gas customers for any earnings that, as a result of the changes in the Tax Act, exceed 9.7 percent ROE. Beginning in May 2018, the Company will commence making quarterly financial filings with the Commission detailing the financial performance of the Company's natural gas operations that demonstrate its earnings for a prior twelve-month rolling period factoring in the Tax Act change that occurred on January 1, 2018, and, to the extent that prior twelve-month rolling period produced natural gas earnings over 9.7 percent, an appropriate

Rider TA adjustment, and for future filings, any necessary prior period true-up. The Company will implement this first credit thirty days after the first quarterly filing that demonstrates the Company's natural gas return on equity exceeds 9.7 percent. Rider TA will remain in effect until the Company's new natural gas base rates would go into effect, sometime in 2019. The mechanism will be cancelled and withdrawn concurrent with the implementation of new natural gas base rates, which will then reflect the impact of the Tax Act.

Q. HAS THE COMMISSION APPROVED SIMILAR MECHANISMS IN THE PAST?

A. Yes. At least one example is the Commission's approval of an earnings sharing mechanism it approved for Kentucky Utilities, Inc., (KU) in Case No. 1998-00474. In its January 7, 2000, Order the Commission approved a mechanism that set a threshold return on equity and allowed KU to credit or charge customers to the extent its ROE fell above or below a deadband around the threshold return on equity.

The Company is not proposing to implement an earnings sharing mechanism in this case but it is important to note that the concepts and principles of this mechanism that the Commission has approved in the past are similar to what the Company is proposing here with respect to Rider TA.

Q. WHY IS THIS PROPOSAL REASONABLE?

A. This proposal is reasonable in that it ensures that the Company is ahle to earn a fair, just and reasonable rate of return notwithstanding the impacts of the Tax Act and all other upward pressure on rates that the Company has experienced since

2010, as well as those that may be impacting rates going forward. The Company is already creating the deferrals for the excess ADIT liabilities. The issue for the amortization of these assets is not so much a question of how, just when. Allowing the Company to delay implementing an immediate base rate adjustment until such time as the Commission has the opportunity to fully consider all costs that are impacting cost of service will enable Duke Energy Kentucky to maintain its financial condition and not risk a sudden creditworthiness concern.

Q. WHY ARE YOU PROPOSING TO USE A RIDER TO ADDRESS THE TAX ACT IMPACTS RATHER THAN AN ADJUSTMENT TO BASE RATES?

A. The proposed rider mechanism will enable the Company and the Commission to track the Company's actual performance and determine whether or not there are excessive earnings within any quarterly period until new base rates are in effect following a base rate case. Rider TA will ensure that the Company is not charging unjust, unfair, or unreasonable rates by flow through any earnings the Company experiences above the threshold. Importantly, the Company is not proposing that the rider be used as a minimum earnings floor, *i.e.*, to the extent the Company's monthly natural gas earnings remain below a fair, just, and reasonable level, this mechanism will not be used to create a floor. The risk of any continued natural gas earnings erosion is solely on the Company. This will act as an incentive for the Company to continue to look for ways to manage its costs for customers.

Q. PLEASE EXPLAIN HOW CUSTOMERS WILL EXPERIENCE SOME IMMEDIATE RELIEF UNDER THE TAX ACT FOR THE REDUCTION IN CORPORATE TAX EXPENSE.

A. To the extent Duke Energy Kentucky already has riders, or other surcharge mechanisms in place that automatically adjust for costs, including taxes, outside of a base rate case, customers will automatically experience those savings in the normal course of operation of those riders.

Q. HOW CAN THE COMMISSION PROVIDE ADDITIONAL PROTECTION TO CUSTOMERS IN THE FUTURE AS A RESULT OF OTHER TAX ACT CHANGES?

A. The Tax Act is clear on the treatment of excess ADITs that are tied to property, and that must occur over the life of those assets. The most appropriate way to address that is through an amortization schedule that is approved in a base rate case. To the extent there are unprotected excess ADITs, the Commission should take the opportunity now, to consider opportunities to use those excess ADITs in a manner that will provide a longer-term benefit to customers and the utility and not harm either customers or the Company's financial condition. Duke Energy Kentucky has and will continue to evaluate and propose reasonable mitigation strategies for the Commission's consideration that will be intended to address the other impacts of the Tax Act that will be providing upward pressure on customer rates.

Q. ARE YOU AWARE OF ANY OTHER JURISDICTIONS THAT ARE USING THE RECENTLY ENACTED CHANGES IN THE TAX ACT TO IMPACT LONG-TERM UTLITY RATES IN A MEANINGFUL WAY?

A. Yes. Many regulators throughout the country are coping with the implications of the Tax Act and have, in their own ways, sought to ensure that customers get their due benefits from the change in tax law. There are unquestionably many ways for the regulated utilities to accomplish this objective. As an example, I have included Attachment WDW-1, which is a copy of a recent press release by Florida Power & Light Company (FP&L) that describes using the Tax Act changes to offset other rising costs including Hurricane Irma restoration expenses and to delay future rate cases. The proposal by FP&L essentially allows it to use the cash benefit it will derive from the Tax Act to shelter customers from having to pay for costs it has already incurred but has not yet recovered. The Commission should consider alternatives where such opportunities exist for Duke Energy Kentucky.

Q. DOES DUKE ENERGY KENTUCKY HAVE ANY DEFERRALS FOR COSTS INCURRED THAT HAVE NOT YET BEEN RECOVERED IN RATES?

A. Yes. The Company has a number of accounting deferrals that the Commission has approved in prior cases. Table 1, below, is a summary of the regulatory assets, approved by the Commission, showing the projected balance to be recovered, as of March 31, 2018, the case number for which the regulatory asset was approved, and a reference to the revenue requirement adjustment reflecting the proposed amortization of the regulatory asset. Traditional ratemaking involves amortizing the balance of a regulatory asset over some period of time that is fair and reasonable to the customer and the shareholder.

Description	Projected Balance as of 3/31/18	Approved in Case No.
AMI Opt Out	$263,029	2016-00152
East Bend Depreciation	$11,529,520	2015-00120
East Bend O&M	$39,162,337	2014-00201
Storm Cost	$4,912,800	2008-00476
Carbon Mgt Research	$2,000,000	2008-00308
AMI Meter Change-Out	$6,958,958	2016-00152
Ash ARO costs deferred to date	$15,521,339	2015-00187
Ash ARO costs to be incurred	$24,282,309	2015-00187
Natural Gas Pressure Testing	$2,887,115	2016-00159

The changes from the Tax Act including the liabilities associated with the creation of the excess ADITs could be used to offset these deferrals and future costs so to manage future rate increases to customers. The Company is merely offering these suggestions for Commission consideration as different opportunities to assist customers with mitigating rate impacts over the longer term.

V. CONCLUSION

Q. DO YOU BELIEVE DUKE ENERGY KENTUCKY'S PROPOSAL TO ADDRESS THE IMPACTS OF THE TAX ACT IS REASONABLE?

A. Yes.

Q. WAS ATTACHMENT WDW-1 PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes.

Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?

A. Yes.

VERIFICATION

STATE OF OHIO	)	
	)	**SS:**
COUNTY OF HAMILTON	)	

The undersigned, William Don Wathen Jr., Director of Rates & Regulatory Strategy, being duly sworn, deposes and says that he has personal knowledge of the matters set forth in the foregoing testimony and that it is true and correct to the best of his knowledge, information and belief.

William Don Wathen Jr., Affiant

Subscribed and sworn to before me by William Don Wathen, Jr., on this 24TH day of JANUARY, 2018.

Adele M. Frisch

NOTARY PUBLIC

ADELE M. FRISCH
Notary Public, State of Ohio
My Commission Expires 01-05-2019

My Commission Expires: 1/5/2019

FPL.

Florida Power & Light Co.
Media Line: 561-694-4442
January 16, 2018
@FPL_Newsroom

FOR IMMEDIATE RELEASE

FPL to apply federal tax savings toward $1.3 billion cost of Hurricane Irma to prevent increase in customer rates

- *Because of federal tax savings beginning in 2018, FPL will not need to raise rates to pay for the unprecedented Hurricane Irma restoration – saving each of FPL's 4.9 million customers an average of $250*
- *Already among the lowest in the nation, FPL's typical 1,000-kWh customer bill also will drop to nearly 30 percent below the latest national average with a decrease of $3.35 a month that will take effect March 1 with the completion of Hurricane Matthew recovery*
- *Tax savings in future years may enable FPL to continue the current rate agreement and avoid a general base rate increase potentially through the end of 2022*

JUNO BEACH, Fla. – Florida Power & Light Company today announced that customers will not pay a surcharge for Hurricane Irma restoration as previously expected. Instead, FPL plans to apply federal tax savings toward the $1.3 billion cost of Hurricane Irma restoration, which will save each of FPL's 4.9 million customers an average of approximately $250.

In addition, FPL may be able to use future federal tax savings to continue operating under the current base rate agreement beyond the initial term, which covers through 2020, for up to two additional years.

"The timing of federal tax reform, coming on the heels of the most expensive hurricane in Florida history, created an unusual and unprecedented opportunity. We believe the plan we've outlined is the fastest way to begin passing tax savings along to our customers and the most appropriate approach to keeping rates low and stable for years to come," said Eric Silagy, president and CEO of FPL.

Hurricane Irma was one of the largest, most powerful storms to ever hit Florida, and FPL's response was unprecedented both in scale and the speed of power restoration. The company had previously announced its intention to begin recovering the $1.3 billion restoration cost by implementing a surcharge on customer bills through 2020.

The ability to leverage the federal tax savings in this way is afforded by FPL's current bese rate agreement, which was negotiated with the Office of Public Counsel and other customer groups and approved unanimously by the Florida Public Service Commission in 2016. The agreement set parameters for base rates and storm surcharges from 2017 through at least 2020.

"Our current rate agreement provides the ability to use federal tax savings to entirely offset Hurricane Irma restoration costs, which delivers an immediate benefit to customers, and also the potential opportunity to avoid a general base rate increase for up to an additional two years," Silagy said.

Keeping customer bills low
While the prices of almost all products and services have risen in recent years, FPL's typical 1,000-kWh residential customer bill has remained very low. In fact, FPL's typical bill is lower today than it was more than 10 years ago.

Already among the lowest in the nation, FPL's typical 1,000-kWh customer bill will drop to nearly 30 percent below the latest national average with a decrease of $3.35 a month that will take effect March 1 with the completion of the recovery of costs for Hurricane Matthew.

FPL's Typical 1,000-kWh Customer Bill		
2006	**Current**	**Beginning March 1, 2018**
$108.61	**$102.72**	**$99.37**
As of March 1, FPL's typical bill will be approximately 15% lower than the state average and 29% lower than the U.S. average, according to the latest available data.		
Sources: State average ($116.61) reflects November 2017 bills reported by 42 Florida electric utilities; U.S. average ($139.86) is based on Summer 2017 bills from 175 utilities, published by the Edison Electric Institute		

Florida Power & Light Company
Florida Power & Light Company is the third-largest electric utility in the United States, serving nearly 5 million customer accounts or an estimated 10 million+ people across nearly half of the state of Florida. FPL's typical 1,000-kWh residential customer bill is approximately 25 percent lower than the latest national average and among the lowest in the U.S. FPL's service reliability is better than 99.98 percent, and its highly fuel-efficient power plant fleet is one of the cleanest among all utilities nationwide. The company was recognized in 2017 as one of the most trusted U.S. electric utilities by Market Strategies International for the fourth consecutive year. A leading Florida employer with approximately 8,900 employees, FPL is a subsidiary of Juno Beach, Florida-based NextEra Energy, Inc. (NYSE: NEE), a clean energy company widely recognized for its efforts in sustainability, ethics and diversity, and has been ranked No. 1 in the electric and gas utilities industry in Fortune's 2017 list of "World's Most Admired Companies." NextEra Energy is also the parent company of NextEra Energy Resources, LLC, which, together with its affiliated entities, is the world's largest generator of renewable energy from the wind and sun. For more information about NextEra Energy companies, visit these websites: www.NextEraEnergy.com, www.FPL.com, www.NextEraEnergyResources.com.

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Cautionary Statements and Risk Factors That May Affect Future Results

This news release contains "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical facts, but instead represent the current expectations of NextEra Energy, Inc. (NextEra Energy) and Florida Power & Light Company (FPL) regarding future operating results and other future events, many of which, by their nature, are inherently uncertain and outside of NextEra Energy's and FPL's control. Forward-looking statements in this news release include, among others, statements concerning future operating performance. In some cases, you can identify the forward-looking statements by words or phrases such as "will," "may result," "expect," "anticipate," "believe," "intend," "plan," "seek," "potential," "projection," "forecast," "predict," "goals," "target," "outlook," "should," "would" or similar words or expressions. You should not place undue reliance on these forward-looking statements, which are not a guarantee of future performance. The future results of NextEra Energy and FPL and their business and financial condition are subject to risks and uncertainties that could cause their actual results to differ materially from those expressed or implied in the forward-looking statements, or may require them to limit or eliminate certain operations. These risks and uncertainties include, but are not limited to, the following: effects of extensive regulation of NextEra Energy's and FPL's business operations; inability of NextEra Energy and FPL to recover in a timely manner any significant amount of costs, a return on certain assets or a reasonable return on invested capital through base rates, cost recovery clauses, other regulatory mechanisms or otherwise; impact of political, regulatory and economic factors on regulatory decisions important to NextEra Energy and FPL; disallowance of cost recovery by FPL based on a finding of imprudent use of derivative instruments; effect of any reductions or modifications to, or elimination of, governmental incentives or policies that support utility scale renewable energy projects of NextEra Energy Resources, LLC and its affiliated entities (NextEra Energy Resources) or the imposition of additional tax laws, policies or assessments on renewable energy; impact of new or revised laws, regulations, interpretations or other regulatory initiatives on NextEra Energy and FPL;; capital expenditures, increased operating costs and various liabilities attributable to environmental laws, regulations and other standards applicable to NextEra Energy and FPL; effects on NextEra Energy and FPL of federal or state laws or regulations mandating new or additional limits on the production of greenhouse gas emissions; exposure of NextEra Energy and FPL to significant and increasing compliance costs and substantial monetary penalties and other sanctions as a result of extensive federal regulation of their operations and businesses; effect on NextEra Energy and FPL of changes in tax laws, guidance or policies as well as in judgments and estimates used to determine tax-related asset and liability amounts; impact on NextEra Energy and FPL of adverse results of litigation; effect on NextEra Energy and FPL of failure to proceed with projects under development or inability to complete the construction of (or capital improvements to) electric generation, transmission and distribution facilities, gas infrastructure facilities or other facilities on schedule or within budget; impact on development and operating activities of NextEra Energy and FPL resulting from risks related to project siting, financing, construction, permitting, governmental approvals and the negotiation of project development agreements; risks involved in the operation and maintenance of electric generation, transmission and distribution facilities, gas infrastructure facilities and other facilities; effect on NextEra Energy and FPL of a lack of growth or slower growth in the number of customers or in customer usage; impact on NextEra Energy and FPL of severe weather and other weather conditions; threats of terrorism and catastrophic events that could result from terrorism, cyber attacks or other attempts to disrupt NextEra Energy's and FPL's business or the businesses of third parties; inability to obtain adequate insurance coverage for protection of NextEra Energy and FPL against significant losses and risk that insurance coverage does not provide protection against all significant losses; a prolonged period of low gas and oil prices could impact NextEra Energy Resources' gas infrastructure business and cause NextEra Energy Resources to delay or cancel certain gas infrastructure projects and for certain existing projects to be impaired; risk to NextEra Energy Resources of increased operating costs resulting from unfavorable supply costs necessary to provide NextEra Energy Resources' full energy and capacity requirement services; inability or failure by NextEra Energy Resources to manage properly or hedge effectively the commodity risk within its portfolio; effect of reductions in the liquidity of energy markets on NextEra Energy's ability to manage operational risks; effectiveness of NextEra Energy's and FPL's risk management tools associated with their hedging and trading procedures to protect against significant losses, including the effect of unforeseen price variances from historical behavior; impact of unavailability or disruption of power transmission or commodity transportation facilities on sale and delivery of power or natural gas by FPL and NextEra Energy Resources; exposure of NextEra Energy and FPL to credit and performance risk from customers, hedging counterparties and vendors; failure of NextEra Energy or FPL counterparties to perform under derivative contracts or of requirement for NextEra Energy or FPL to post margin cash collateral under derivative contracts; failure or breach of NextEra Energy's or FPL's information technology systems; risks to NextEra Energy and FPL's retail businesses from compromise of sensitive customer data; losses from volatility in the market values of derivative instruments and limited liquidity in OTC markets; impact of negative publicity; inability of NextEra Energy and FPL to maintain, negotiate or renegotiate acceptable franchise agreements with municipalities and counties in Florida; occurrence of work strikes or stoppages and increasing personnel costs; NextEra Energy's ability to successfully identify, complete and integrate acquisitions, including the effect of increased competition for acquisitions; NextEra Energy Partners, LP's (NEP's) acquisitions may not be completed and, even if completed, NextEra Energy may not realize the anticipated benefits of any acquisitions; environmental, health and financial risks associated with NextEra Energy Resources' and FPL's ownership and operation of nuclear generation facilities; liability of NextEra Energy and FPL for significant retrospective assessments and/or retrospective insurance premiums in the event of an incident at certain nuclear generation facilities; increased operating and capital expenditures and/or result in reduced revenues at nuclear generation facilities of NextEra Energy or FPL resulting from orders or new regulations of the Nuclear Regulatory Commission; inability to operate any of NextEra Energy Resources' or FPL's owned nuclear generation units through the end of their respective operating licenses; effect of disruptions, uncertainty or volatility in the credit and capital markets on NextEra Energy's and FPL's ability to fund their liquidity and capital needs and meet their growth objectives; inability of NextEra Energy, FPL and NextEra Energy Capital Holdings, Inc. to maintain their current credit ratings; impairment of NextEra Energy's and FPL's liquidity from inability of credit providers to fund their credit commitments or to maintain their current credit ratings; poor market performance and other economic factors that could affect NextEra Energy's defined benefit pension plan's funded status; poor market performance and other risks to the asset values of NextEra Energy's and FPL's nuclear decommissioning funds; changes in market value and other risks to certain of NextEra Energy's investments; effect of inability of NextEra Energy subsidiaries to pay upstream dividends or repay funds to NextEra Energy or of NextEra Energy's performance under guarantees of subsidiary obligations on NextEra Energy's ability to meet its financial obligations and to pay dividends on its common stock; the fact that the amount and timing of dividends payable on NextEra Energy's common stock, as well as the dividend policy approved by NextEra Energy's board of directors from time to time, and changes to that policy, are within the sole discretion of NextEra Energy's board of directors and, if declared and paid, dividends may be in amounts that are less than might be expected by shareholders; NEP's inability to access sources of capital on commercially reasonable terms could have an effect on its ability to consummate future acquisitions and on the value of NextEra Energy's limited partner interest in NextEra Energy Operating Partners, LP; and effects of disruptions, uncertainty or volatility in the credit and capital markets on the market price of NextEra Energy's common stock. NextEra Energy and FPL discuss these and other risks and uncertainties in their annual report on Form 10-K for the year ended December 31, 2016 and other SEC filings, and this news release should be read in conjunction with such SEC filings made through the date of this news release. The forward-looking statements made in this news release are made only as of the date of this news release and NextEra Energy and FPL undertake no obligation to update any forward-looking statements.