

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| 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. |) | |

DUKE ENERGY KENTUCKY, INC.'S
ANSWER TO COMPLAINT AND OFFER OF SATISFACTION

Comes now Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company), by and through counsel, pursuant to the Commission's December 27, 2017 Order, and other applicable law, and tenders its Answer to the Formal Complaint filed on or about December 21, 2017, by Kentucky Industrial Utility Customers, Inc., (KIUC), respectfully stating as follows:

COUNTER-STATEMENT OF THE CASE

1. On December 22, 2017, President Donald J. Trump signed into law the Tax Cuts and Jobs Act (Tax Act). Among other provisions that are contained in this tax legislation are provisions that will have significant impacts upon most, if not all, investor-owned public utilities providing services in the Commonwealth of Kentucky.

2. On December 21, 2017, the KIUC filed the instant action seeking relief as a result of the then anticipated changes attributed to the impending Tax Act (Complaint). Specifically, the KIUC's Complaint focused only on two issues of the Tax Act, namely: 1) the reduction in the

maximum federal corporate income tax rate; and 2) the amortization of excess accumulated deferred income taxes (ADITs) stemming from the change in the tax rate.¹

3. On December 27, 2017, the Commission issued an Order that, among other things, directed Duke Energy Kentucky to “record a deferred liability starting January 1, 2018, to reflect both the reduced corporate tax rate expense of 21 percent and the excess accumulated deferred income taxes to be returned over 20 years.”² As directed by the Commission, Duke Energy Kentucky will use its best estimate to establish such liabilities as it closes its 2017 corporate books³ and for the required deferrals beginning January 1, 2018.

4. While the Tax Act substantially reduces the federal tax rate upon corporations from the previous 35 percent to 21 percent effective January 1, 2018, the Tax Act makes further changes to the current tax code that will have significant impacts (positive and negative) to utilities, including Duke Energy Kentucky and its customers. The above-styled Complaint and the Commission’s subsequent Order both fail to account for the totality of the impacts created by the passage of the Tax Act. These additional changes must also be considered in concert and not in isolation with the single issue alleged in this Complaint. As previously articulated by other co-defendants to this proceeding, the Complaint fails to account for the following significant changes to the existing taxing structure for utilities, including, among other things:

- a. For excess deferred taxes related to property, the Tax Act requires normalization of the excess deferred taxes into customer rates in a highly-prescribed manner that mimics the remaining life of the underlying asset;⁴

¹ Complaint at 2.

² The Commission’s proposed twenty-year amortization period for all excess accumulated deferred income taxes is inconsistent with the Tax Act as tax normalization rules will dictate the ultimate period over which the excess ADITs that are property related will be amortized.

³ As a combination gas and electric utility, the Company will have separate liabilities for each business unit.

⁴ Tax Cuts and Jobs Act, H.R. 1, Public Law 115-97, 131 Stat. 2054 (Dec. 22, 2017); §1561. Limitation on Accumulated Earnings Credit in the Case of Certain Controlled Corporations.

- b. The Tax Act will directly impact Duke Energy Kentucky's capitalization as a result of the elimination of bonus depreciation and other changes to deferred taxes, including the amortization of deferred taxes;
- c. The Complaint fails to acknowledge the impact on the state income tax deduction due to the lower federal income tax rate;
- d. The Complaint fails to distinguish between "actual" taxes recorded in financial statements reported to the FERC and taxes actually being collected from customers in base rates; and
- e. To support its position, the Complaint includes inaccurate calculations of the estimated impact of the Tax Act to Duke Energy Kentucky.⁵

5. Utility rates must be set to a level that allows the Company the opportunity to recover all its reasonable expenses, including taxes and to provide its shareholders with an opportunity to earn a fair return on their capital investment. Indeed, Duke Energy Kentucky currently has pending before the Commission a base electric rate case that demonstrates that the Company is currently not earning a fair return on its investment, nor is it recovering its reasonable expenses in providing service to its customers. The impact of the Tax Act must not and should not be addressed separately from the Company's currently pending base electric rate case.

6. Duke Energy Kentucky's natural gas base rates are not excessive as a result of the Tax Act. In fact based upon initial estimates of the impact of the Tax Act on the Company, its

⁵ The Tax Act continues to be examined by Duke Energy Kentucky and, due to the legislation's complexity, it will take some time before the full ramifications of the Tax Act are fully known. Duke Energy Kentucky therefore reserves the right to advise the Commission of additional implications arising from the Tax Act as they become more fully known and experienced.

current base rates remain insufficient to allow the Company to recover its reasonable costs of providing service and provide an opportunity to earn a reasonable return on its invested capital.

7. Duke Energy Kentucky desires to determine whether the issues raised in the Complaint can be resolved efficiently and expeditiously, and, accordingly is tendering an Offer of Satisfaction with its Answer and testimony. The Offer of Satisfaction is described in further detail at the conclusion of the Answer.

ANSWER

1. Duke Energy Kentucky admits that the Kentucky Public Service Commission (Commission) has jurisdiction over the “rates” and “service” of Duke Energy Kentucky, as those terms are defined in KRS 278.010, and that any dispute over the general rates and service of the Company are properly heard by the Commission.

2. Duke Energy Kentucky does not have sufficient information or belief to admit or deny the averments contained in numerical paragraphs 2 through 9 of the Complaint and therefore denies same.

3. Duke Energy Kentucky admits the averments contained in paragraphs 10 and 11 of the Complaint.

4. With regard to paragraph 12 of the Complaint, Duke Energy Kentucky admits that the United States Congress passed significant tax legislation on or about December 20, 2017.

5. Duke Energy Kentucky denies the averments contained in numerical paragraphs 13 and 14 and states that, upon information and belief, President Trump has already signed the tax legislation referred to above.

6. Duke Energy Kentucky admits the averments contained in numerical paragraph 15 of the Complaint. Duke Energy Kentucky further states that there are additional provisions in

the Tax Act that will also impact Duke Energy Kentucky and these impacts should also be taken into account by this Commission in a separate case or, more appropriately, in the context of base rate proceedings.

7. Duke Energy Kentucky denies the averments contained in paragraph 16 of the Complaint as it pertains to the Company on the basis that the Company does not currently have an environmental surcharge tariff in effect. Moreover, there is never a guarantee that the tax expense recognized in a utility's test year will be actually recovered after those rates have been put into effect. Duke Energy Kentucky is without information or belief sufficient to allow it to admit or deny the remaining averments of said paragraph and therefore denies same.

8. Duke Energy Kentucky admits that its current base rates for electric and natural gas were established based on test year revenue requirements that included the federal tax rates in effect at the time those base rates were approved. Duke Energy Kentucky denies the remaining averments of paragraph 17 of the Complaint.

9. Duke Energy Kentucky states that KRS 278.030(1), selectively quoted in numerical paragraph 18 of the Complaint, speaks for itself and no admission or denial is necessary.

10. Duke Energy Kentucky denies the averments contained in numerical paragraph 19 of the Complaint as it pertains to the effect the Tax Act will have on the Company's rates. Duke Energy Kentucky states that its current electric and natural gas rates are unfair, unjust and unreasonable for the reason that they are too low and insufficient to recover the Company's reasonable costs and provide an opportunity to earn a reasonable return on its invested capital even when the effect of the decrease in federal tax rates is taken into effect. The assertion that the Company's base rates are too low has not been contradicted by the Complainant in the

context of Duke Energy Kentucky's pending electric base rate case. Duke Energy Kentucky is without information or belief sufficient to allow it to admit or deny the remaining averments of said paragraph and therefore denies same.

11. Duke Energy Kentucky admits that its existing tariffed rates reflect the tax code in effect at the time the rates were put into effect. Duke Energy Kentucky will reclassify the excess deferred taxes as a regulatory liability based upon reasonable estimates as it closes its books for the year ended December 31, 2017 as directed by the Commission. Amortization of all property-related excess ADITs will be determined using normalization principles as required by the Tax Act. Excess deferred taxes for non-property items, will also be reclassified to the regulatory liability. Duke Energy Kentucky expects the amortization periods for these property and non-property excess deferred taxes to be determined and established in its current electric or next natural gas base rate case. Duke Energy Kentucky will continue to review and adjust the regulatory liability as it closes its books for the year ended December 31, 2017 and going forward.

12. Duke Energy Kentucky acknowledges the statements in paragraph 21 of the Complaint generally illustrate the long-standing equity gross-up procedure used in ratemaking. The Company denies that the example in paragraph 21 of the Complaint is a reasonable representation of the full equity gross-up procedure because it does not include the gross-up for state corporate income taxes, the gross-up for bad debt expense, or the Commission's assessment fee. Including the state statutory rate in the calculation of the gross-up factor will change the current blended income tax rate used in the gross-up factor from 38.9 percent to 25.74 percent. Duke Energy Kentucky otherwise admits that its revenue requirement will be reduced through a

reduction in the equity gross-up because of the effects of the Tax Act but denies that the reduction in the federal tax rate will necessarily make its rates unfair, unjust or unreasonable.

13 Duke Energy Kentucky denies the averments contained in paragraph 22 of the Complaint as they pertain to the Company. ADITs are simply the result of a difference in timing when a utility pays taxes and when it recovers the payment of taxes from the ratepayer. Duke Energy Kentucky is without information or belief sufficient to allow it to admit or deny the remaining averments of paragraph 22 and therefore denies same.

14. Duke Energy Kentucky admits that numerical paragraph 23 of the Complaint quotes from the Edison Electric Institute's February 2013 report. That report, when read *in toto*, speaks for itself.

15. Duke Energy Kentucky states that the averments contained in paragraphs 24 through 27 of the Complaint are selective quotations from, and commentary upon, prior Commission Orders which, when read *in toto*, speak for themselves.

16. Duke Energy Kentucky states that the averments contained in paragraph 28 of the Complaint are taken from a document from Regulatory Research Associates which, when read *in toto*, speaks for itself.

17. Duke Energy Kentucky states that the averments contained in paragraphs 29 through 31 of the Complaint are selective quotations from, and commentary upon, prior Commission Orders which, when read *in toto*, speak for themselves.

18. Duke Energy Kentucky admits the averments contained in numerical paragraph 32.

19. Duke Energy Kentucky states that the averments contained in paragraph 33 of the Complaint are selective quotations from an Opinion of the Kentucky Supreme Court which,

when read *in toto*, speaks for itself. In point of fact, the tariffed rate at issue in the Supreme Court case was considered and approved by the Commission in the context of base rate cases, not in the context of single issue rate cases.

20. Duke Energy Kentucky denies the averments contained in paragraphs 34 through 35 of the Complaint as they pertain to the Company. Duke Energy Kentucky is without information or belief sufficient to allow it to admit or deny the remaining averments of paragraphs 34 through 35 and therefore denies same.

21. All averments not expressly admitted herein are hereby expressly denied.

AFFIRMATIVE DEFENSES

1. The Complaint fails to state a claim for which relief may be granted.

2. The Complaint is barred by the fact that KIUC has not identified which of its participating members is an industrial electric and/or natural gas customer of Duke Energy Kentucky and, therefore, KIUC lacks standing to challenge the electric and natural gas rates of Duke Energy Kentucky.⁶ The Commission should dismiss the KIUC's complaint as it pertains to Duke Energy Kentucky.

3. Duke Energy Kentucky currently has an application for an increase in its base electric rates pending before the Commission and any question regarding the fairness, justness, and reasonableness of its electric rates should be determined in that proceeding, including consideration of the impacts of the Tax Act on the overall revenue requirement. In fact, the identical issue of the impact of the federal tax legislation upon the rates of Duke Energy Kentucky has been raised by intervening parties in Duke Energy Kentucky's pending electric

⁶ In Duke Energy Kentucky, Inc.'s pending rate case (Case No. 2017-00321), KIUC intervened on behalf of River Metals Recycling, a wholly-owned subsidiary of Nucor, Inc. River Metals Recycling is not listed in KIUC's Complaint as a participating member.

rate case, including by witness Mr. Kollen, who has filed direct testimony in that proceeding.⁷ The Complaint unnecessarily seeks to direct the Commission toward undertaking a single-issue ratemaking procedure, wherein KIUC would itself have the burden of proof, when there already exists an open docket that allows the Commission to consider the full effect of the Tax Act without resorting to single-issue ratemaking.

4. The federal tax legislation passed by Congress and signed by President Trump is voluminous and complex. If the Commission should determine to make an adjustment to the Company's rates based upon the passage of said legislation, it should do so with the entirety of the legislation in mind. A brief summary of these issues was set forth in Duke Energy Kentucky's Counter-Statement of the Case above. KIUC's Complaint does not account for every provision of the legislation that will likely have an impact upon the costs and expenses of Duke Energy Kentucky.

5. It is unnecessarily costly and inefficient to have this case proceed as a single proceeding involving multiple utilities. In the event that the Commission chooses not to dismiss the Complaint against Duke Energy Kentucky on the basis that neither KIUC, nor its identified members, are customers of the Company and therefore lack standing to pursue the Complaint, the Commission should open separate proceedings pertaining to each affected utility subject to the Commission's jurisdiction. To that end, the effects of the Tax Act would be examined in the specific context of each utility named as a defendant herein and with regard to the actual financial condition of each utility. Moreover, the effect of the Tax Act on the Company's electric base rates should be evaluated in the context of Duke Energy Kentucky's pending electric base rate case and the only subject which would be properly before the Commission in this proceeding should be the effect of the Tax Act on the natural gas base rates of the Company.

⁷ See Case No. 2017-00321, Testimony of Lane Kollen (filed December 29, 2017).

OFFER OF SATISFACTION

1. Duke Energy Kentucky agrees that customers should receive an appropriate share of the benefits under the Tax Act on a timely basis. It is incumbent on the Commission to ensure that customers receive and the utility is providing reliable service at reasonable rates. But without thoughtful consideration of the Commission of all aspects of the Tax Act, the Company could be adversely affected by the legislation, particularly through a material reduction of much needed cash flow. The changes in the Tax Act provide the Commission with a unique opportunity to help reduce and smooth out customer rates over the short- and longer-term, while maintaining the utility's ability to provide safe, reliable and affordable rates. The Company has worked hard over the years to keep customers' rates below the national average while providing safe, reliable and increasingly clean energy. Keeping with this strong tradition, the Company proposes both near- and longer-term solutions that will lower customer bills immediately and help off-set future rate increases while balancing the interest in maintaining a financially sound utility:

a. Electric Operations:

- i. Duke Energy Kentucky proposes that any impacts of the Tax Act attributed to its revenue requirement for retail electric service be addressed in the Company's currently pending base electric rate proceeding, Case No. 2017-00321.
- ii. Duke Energy Kentucky's application and supporting testimony filed on September 1, 2017, in Case No. 2017-00321, demonstrates that its current base revenue is insufficient to recover its cost of service by approximately \$48.6 million, excluding any impacts from passage of the Tax Act.

- iii. Even assuming that KIUC's estimated impact of the Tax Act is correct, which the Company disputes, the Company's current electric revenue deficiency more than offsets the reduction in tax expense created under the Tax Act.
 - iv. The Company anticipates that it will update its revenue requirement calculation in the pending electric base rate case to incorporate the impacts of the Tax Act when it files its rebuttal testimony on February 14, 2018. Reflecting the impacts of the Tax Act in the test year revenue requirement along with all other components of the Company's test year revenue requirement will promote efficiency, eliminating any customer confusion that could occur if the Company's base electric rates were to adjust twice within the span of a couple of months to separately reflect changes as a result of the Tax Act and the Company's base electric rate case. Considering the Tax Act in the context of the rate case enables the Commission to consider the reasonableness of all components of the Company's rates.
- b. Gas Operations:
- i. Duke Energy Kentucky's Rider ASRP and its DSM mechanism already have procedural provisions to provide a true-up of actual tax rates and associated base rate amounts. Customers will receive the benefits, and corresponding expenses associated with the Tax Act per the structure of these mechanisms as they are updated.

- ii. Duke Energy Kentucky's current natural gas base rates are currently insufficient to enable the Company to recover its reasonably incurred costs or to provide an opportunity to earn a reasonable return on its invested capital. Based upon the Company's current rates, including riders, Duke Energy Kentucky's current financial projections for 2018, demonstrate its revenues are projected to earn a return of approximately 6.53 percent assuming no changes in customer rates as a result of the Tax Act. If however, the Company adjusts its revenue requirement and customer rates for the changes in the Tax Act to reflect the lower federal income tax rate, the Company's estimated return actually falls to 5.29 percent for 2018. As such, Duke Energy Kentucky's earnings are far from excessive, and are actually insufficient to provide an opportunity to earn a reasonable return or recover its reasonable expenses. Notwithstanding the effect of the Tax Act, Duke Energy Kentucky anticipates the need and commits to file a natural gas base rate case during 2018.
- iii. Nonetheless, to enable the Company's natural gas customers to receive an immediate rate impact as a result in the change in the corporate tax rate in a fair and equitable manner that ensures the Company will not be adversely impacted due to a reduction in necessary cash flow nor have excessive earnings or unreasonably insufficient rates, Duke Energy Kentucky proposes to implement a Tax Act earnings tracking mechanism (Rider TA) to credit its natural gas customers with any rolling twelve-

month earnings from its natural gas operations that exceed 9.7 percent return on equity due to the passage of the Tax Act.⁸

- iv. Because the Company's current rates, prior to the implementation of the Tax Act produced a significant earnings deficiency, it is unreasonable to require the Company to reduce its rates even further. Nonetheless, to the extent the changes under the Tax Act contribute to or cause the Company's return on equity to exceed 9.7 percent the Company agrees that it will credit such excess to customers until such time new natural gas base rates can be approved by this Commission in the Company's soon-to-be-filed natural gas base rate case.
- v. 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 rolling twelve-month period, factoring in the Tax Act changes that occurred as of January 1, 2018, and, to the extent that prior 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 the 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 go into effect, sometime in 2019 at which time

⁸ The Company's last base natural gas case, approved in 2010, resulted in an authorized return on equity of 10.375 percent. The Commission approved a 9.7 return on equity for use in the company's Accelerated Service Line Replacement Program, Rider ASRP in 2016.

the impacts of the Tax Act will be reflected in the Company's new natural gas base rates.

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky, Inc. respectfully asks that:

1. The Complaint should be dismissed without prejudice for failure to demonstrate that KIUC or any of its members are customers of Duke Energy Kentucky and therefore lack standing to challenge the rates of Duke Energy Kentucky;
2. All effects of the Tax Act upon the electric base rates of Duke Energy Kentucky should be considered in the context of the Company's pending electric base rate case;
3. The Offer of Settlement tendered herein should be accepted;
4. Duke Energy Kentucky should be awarded its costs, expenses, and attorneys' fees; and
5. Duke Energy Kentucky be awarded all other relief to which it may be entitled.

This 26th day of January 2018.

Duke Energy Kentucky, Inc.



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing filing was served on the following via overnight mail, this 26th day of January, 2018.



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