

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

KENTUCKY INDUSTRIAL UTILITY)	
CUSTOMERS, INC.,)	
)	
COMPLAINANT)	
)	CASE NO. 2018-00036
V.)	
)	
DUKE ENERGY KENTUCKY, INC.)	
)	
DEFENDANT)	

**ATTORNEY GENERAL’S COMMENTS ON PROPOSED NON-UNANIMOUS
STIPULATION AND SETTLEMENT AGREEMENT**

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), and hereby submits his Comments on the Proposed Non-unanimous Stipulation and Settlement Agreement (“Comments”) in this matter.

STATEMENT OF THE CASE

On March 2, 2018 Duke Energy Kentucky (“Duke”) and Kentucky Industrial Utility Customers, Inc. (“KIUC”), filed a Non-unanimous Stipulation and Settlement Agreement (“Stipulation”) in this matter as an attachment to the Direct Testimony of William Don Wathen Jr. (“Testimony”). The purpose of the Stipulation is, “to provide the natural gas customers of Duke Energy Kentucky with an immediate benefit from the passage of the Tax Act.”¹ Upon review of the Stipulation, the Attorney General submits that as presented it is

¹ Stipulation (Ky. PSC March 2, 2018) at 3, ¶ 1.2.

Duke, not its natural gas customers, which is receiving the bulk of the benefits provided by the Tax Cuts and Jobs Act.

Duke's current gas rates "were established by the Commission to include recovery of the 35 percent federal corporate tax rate on the equity portion of capital investments."² Nonetheless, with the passage of the Tax Cuts and Jobs Act, the corporate income tax rate effective as of January 1, 2018 is 21 percent, rather than 35 percent.³ The Commission has noted that a utility's rates must be set to recover its reasonable expenses and provide its shareholders an *opportunity* to earn a fair return on capital.⁴ The proposed Stipulation guarantees a return on all of Duke's capital allocated to gas, including more than \$57M employed since the last review in Case No. 2009-00202. This is unreasonable.

The Attorney General is in agreement with KIUC and Duke about at least one important aspect of Case No. 2018-00036: "the effects of the Tax Act upon Duke Energy Kentucky's electric rates should be addressed in the context of the Company's pending electric base rate case (Case No. 2017-00321)."⁵ There is no disagreement among all of the parties, and seemingly the Commission, on this subject and all of the parties have acted in accordance with that understanding. KIUC, Duke and the Attorney General have either provided testimony or conducted cross-examination or discovery on the impact of the Tax Act in the electric base rate case. Therefore, the comments provided herein are directly related to the proposed Stipulation dealing solely with Duke's natural gas rates. As such, the Attorney General will provide any position regarding the Tax Act as it relates to electric base rates in his brief in Case No. 2017-00321.

² Case No. 2017-00481, Order (Ky. PSC Dec. 27, 2017) at 1.

³ *Id.*

⁴ *Id.* at 1-2.

⁵ Direct Testimony (Ky. PSC March 2, 2018) at 5.

ARGUMENT

Duke's Methodology Is Its Own, And It Is Unreasonable.

Duke's singular argument as to the reasonableness of its Stipulation is that it "follows the same formula agreed to by the Parties in the Louisville Gas & Electric and Kentucky Utilities Company's ("LG&E/KU") tax complaint case (Case No. 2018-00034)."⁶ Although Duke has ostensibly *attempted* to use the methodology employed by LG&E/KU, Mr. Wathen admitted in a separate proceeding he has not communicated with LG&E/KU regarding their calculations.⁷ As described further herein, Duke's methodology is not the same as employed by LG&E/KU and Duke's methodology produces an absurd result that does not result in fair, just or reasonable rates.

It is well-known that "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."⁸ Duke and LG&E/KU are in vastly different situations and the "methodologies" employed between the two settlements and stipulations are different. While Duke's starting point was a test-year ending more than seven (7) years ago, we are in still in the midst of LG&E/KU's most recent test-year. The vast difference between the two applications becomes apparent when test-year capitalizations from past rate cases are compared against the "forecasted" capitalizations.

In LG&E/KU's settlement, the utilities used a forecasted period reflecting the 16-month period between the effective date of the 21 percent corporate income tax rate and the date in which they anticipate new base rates to take effect, April 30, 2019. It should be noted that this 16-month period includes the second six months of the most recent base rate test-

⁶ Testimony (Ky. PSC March 2, 2018) at 5-6.

⁷ Case No. 2017-00321, March 8, 2018 Video Transcript Evidence [VTE] at 3:16:40.

⁸ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (U.S. 1944); See also *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503, 512 (Ky. App. Jan. 26, 1990).

year, Jan 1, 2018- June 30, 2018. Duke also used a forecasted capitalization, and noted that it anticipates filing a new gas base rate case with rates established for, “approximately March 31, 2019.”⁹ For whatever reason, Duke did not include the first three (3) months of 2018 in its calculation. On page one of WDW-2, Duke applied the “old” “Pre-Tax Return” to gas capitalization from the most recent case to calculate what its shareholder return (plus taxes on that return) would be as an outcome of the last gas base rate case.¹⁰ By applying a similar “Pre-Tax Return” that is updated to reflect a new cost-of-debt, capital structure and lower corporate income rate to its forecasted capitalization, Duke is able to calculate what the theoretical shareholder return (and associated taxes on that return) would be if: 1) Duke was authorized to earn a return on the \$57,423,361 difference between the capitalizations, and 2) Kentucky law guaranteed a fair return on invested capital, rather than an *opportunity* to do so. Neither of these are reasonable, and this calculation leads to a windfall profit for Duke to the detriment of its customers.

Duke is likely to find fault with the Attorney General in settling with LG&E/KU while not supporting this Stipulation, but Duke is likely doing so under the misguided belief that it is using the same method that LG&E/KU employed. The Commission should note that Duke’s contention that its methodology “mirrors” LG&E/KU’s is incorrect. The three utilities are in fundamentally different positions, and as such the application of one methodology creates a reasonable outcome for LG&E/KU and a misapplication of a similar methodology creates an unreasonable one for Duke’s natural gas rates. Duke’s methodology provides the Company a full return on more than \$57M in capitalization the Commission has

⁹ Stipulation (Ky. PSC March 2, 2018) at 4.

¹⁰ See Case No. 2009-00202.

likely neither seen nor reviewed.¹¹ The increase in capitalization that Duke is earning a full return on is a 22.63% increase over the capitalization of the last rate case. Conversely, the changes in capitalization in the LG&E/KU settlement ranged from a 1% decrease to a 2.46% increase. Of course, it is now well known that due to the loss of bonus depreciation¹² and other cash issues, the Tax Cuts and Jobs Act will ultimately lead to higher capitalizations for utilities like Duke.¹³ As such, it is appropriate for incremental capitalization effects to be taken into account when entertaining single-issue rate reductions. It is the Attorney General's position that LG&E/KU's change in capitalization in its settlement was just that; an appropriate update of capitalization to reflect the unintended consequences of the change in federal law. Although a modest increase in capitalization will likely occur, this should not be an invitation to Duke to recover a return on a significant amount of capital outside of a base rate case in which the investment has not been reviewed for prudence or reasonableness. Customers should retain the bulk of savings due to of the Tax Cuts and Jobs Act, while the Commission may ensure there is minimal harm to utilities.

The Commission Has Reasonable Alternatives To Employ For Duke

In its Stipulation Duke is retaining the majority of savings as a result of the Tax Cuts and Jobs Acts. Rather than *trying* to follow LG&E/KU's methodology, it would be much more reasonable for Duke to either: 1) actually follow the LG&E/KU model and only update capitalization for the effects of the Tax Cuts and Jobs Act, or 2) calculate the savings to customers by using a methodology more similar to that employed in the pending settlement

¹¹ The Attorney General will note that the Commission must examine whether capital expended in Duke's accelerated main replacement program and accelerated service line replacement program should be considered in these calculations and determine whether those amounts are included in the forecasted capitalization and if they are, whether they have been reviewed for prudence or reasonableness.

¹² Testimony (Ky. PSC March 2, 2018) at 3.

¹³ Case No. 2017-00321, March 7, 2018 VTE 9:08:20.

between the Attorney General and Atmos Energy Corporation. By employing a similar methodology as to that found in the Settlement in Case No. 2018-00039, Duke would not earn a return on the \$57M of capital employed in the last seven (7) years, and by *actually* following LG&E/KU's methodology the outcome would be more equitable to customers while balancing the negative effects to capitalization.

Either way, provided that it has been nearly a decade since Duke's last natural gas base rate case, strict adherence to either of the above-described methodologies may not be reasonable. For instance, applying the "new" "Pre-Tax Return" of 8.85% as provided for in Attachment WDW-2 to the capitalization of \$253,750,235¹⁴ would result in a reduction of the income tax portion of return reflected in rates, but no longer incurred by the company, of almost \$5M, rather than an "increase" of \$187,000.¹⁵ Although it is undeniable that the Company will not have the same level of tax expense on return going forward as it did when the Commission set rates in Case No. 2009-00202, the Attorney General believes it is likely that returning all of the \$4.9M of reduced expense back to customers would unnecessarily hurt Duke. Rates themselves are set at reasonable levels to recover all expenses and provide utilities an opportunity to earn a reasonable rate of return. For a utility to stay out nearly a decade between rate cases likely means one or two things: 1) revenues are higher than the level in which rates were set, and thus the income tax portion is likely higher than that reflected in base rates, and/or 2) the level of expenses have shifted up and down, possibly offsetting each other. Either way, requiring Duke to give back the entirety of the \$4.9M difference calculated above (or a similar sum) may be unreasonable. As such, the Attorney

¹⁴ As found in Case No. 2009-00202.

¹⁵ $\$253,750,235 * 8.85\% = \$22,456,896$
 $\$27,750,235 - \$22,456,896 = \$4,894,547$

General believes that although a significant amount of the savings must be returned to customers, the Commission has the tools necessary to determine a reasonable level that strikes a balance between the utility and its customers.

Excess Accumulated Deferred Income Taxes

In addition to the above discussion, Duke and KIUC also agreed to return the excess accumulated deferred income taxes (“ADIT”). The Attorney General agrees that Duke should use the average rate assumption method, or “ARAM”, to avoid normalization violations as it relates to protected ADITs. The Attorney General however does not agree with the use of a fifteen-year amortization period for the unprotected excess ADITs. The Attorney General agreed to a fifteen-year amortization period in the LG&E/KU settlement as part of a global settlement, which included significant give and take amongst parties. Importantly, in that matter the parties agreed to the amortization period with full knowledge of the strain a shorter period may cause due to differences in book and tax accounting for pension expense, and Mr. Blake’s testimony specifically addressed that concern.¹⁶ In this matter, the Attorney General submits that the Commission should use a shorter amortization period that properly strikes a balance between Duke and its customers. The period should be between the fifteen-years as provided for in the global, unanimous settlement in Case No. 2018-00034 and the five-years the Attorney General will be advocating for in the fully litigated Case No. 2017-00321.

CONCLUSION

While the Stipulation may provide a compromise between Duke and KIUC, the outcome is unreasonable. Duke gas customers will be paying rates through 2019 that include

¹⁶ Case No. 2018-00034, Direct Testimony of Kent W. Blake (Ky. PSC Jan. 29, 2018) at 10-11.

an expense which has been reduced by 40% percent. Duke's customers, not Duke, should receive the bulk of the savings associated with this reduction. The proposed Stipulation provides for unfair, unjust and unreasonable rates, and thus must be denied. The Commission should ensure that customers are protected, and here that means the return of the savings due to the Tax Cuts and Jobs Act.

Respectfully submitted,

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