In the Matter of:

The Electronic Application of Duke Energy Kentucky, Inc., for: 1) An Adjustment of the Electric Rates; 2) Approval of New Tariffs; 3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 4) All Other Required Approvals and Relief.

Case No. 2019-00271

DUKE ENERGY KENTUCKY, INC.'S POST-HEARING RESPONSE BRIEF ADDRESSING ARGUMENTS MADE IN THE RESPECTIVE BRIEFS OF THE ATTORNEY GENERAL, NORTHERN KENTUCKY UNIVERSITY AND THE KROGER COMPANY

Comes now Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company), by counsel, pursuant to the Commission's February 21, 2020 Order, and other applicable law, and does hereby tender to the Commission its Response Brief, respectfully stating as follows:

I. INTRODUCTION

Many of the factual arguments raised by the Intervenors herein – the Kentucky Attorney General (AG), the Kroger Company (Kroger) and Northern Kentucky University (NKU) – were anticipated and addressed by Duke Energy Kentucky in its initial Brief filed on March 16, 2020. Likewise, there is very little in the way of actual legal authority cited in the Briefs of either NKU or Kroger for which a response might be necessary.\(^1\) Accordingly, the Company will not re-

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\(^1\) NKU’s brief cites only one legal authority in its thirty-one (31) page Brief. Kroger also cites one Commission Order in its six (6) page brief.
address most of the arguments asserted by the Intervenors in their Briefs and will be content to stand upon the arguments it has previously asserted. The Company’s silence herein on various arguments asserted by the Intervenors should be recognized as an effort to achieve administrative economy and not as acquiescence or agreement. Thus, this Response Brief is limited to the few issues which deserve special emphasis or which were not addressed in the Company’s March 16, 2020 Brief.

II. ARGUMENT

A. The AG’s Return on Equity Argument is Unreasonable

The AG is the only intervenor that presents any argument regarding the return on equity (ROE) that should be established in this case. His argument essentially boils down to three points of contention: (1) current interest rates, rather than forward interest rates, should be used in calculating the ROE; (2) flotation costs should be excluded from the ROE calculation; and (3) a one-half growth rate for dividend yields is acceptable for Discounted Cash Flow (DCF) analysis.

With regard to whether a full growth rate or a one-half growth rate is appropriate under the DCF method, it is readily apparent that Mr. Baudino’s only source for supporting such a methodology is himself.\(^2\) The sole purpose of using a one-half growth rate is to artificially and arbitrarily lower a ROE calculation under the DCF method. Mr. Baudino acknowledged in discovery that it is not supported by any credible source.\(^3\) His DCF analysis should be rejected.

Second, Duke Energy Kentucky acknowledges that the Commission has rejected the inclusion of flotation costs in the Company’s past two rate cases, however, it continues to believe that there is a cost of issuing equity not otherwise captured in returns. Indeed, the inclusion of

\(^2\) See AG Brief, p. 11, n. 60.

\(^3\) See AG Response to Duke Energy Kentucky DR-01-015.
flotation costs in a company's cost of capital is specifically recognized by both the Federal Energy Regulatory Commission and Surface Transportation Board.\(^4\) The Company respectfully requests the Commission to reconsider its prior findings on this issue for the reasons set forth in Dr. Roger Morin's testimony.\(^5\)

The third argument advanced by the AG is that the Commission should rely upon current interest rates rather than the forward curve for interest rates when calculating the ROE.\(^6\) As unprecedent events have transpired in the four weeks since the hearing concluded on February 20, 2020, reliance upon current interest rates to predict any future economic environment have been conclusively demonstrated to be an exercise in futility. It is incomprehensible that the AG would rely upon the Federal Reserve's recent emergency use of extraordinary powers to reduce interest rates to approximately 0% as a basis for lowering the Company's ROE. It is almost impossible to conceive a more startling disconnect between the risk-free rate of return and what equity investors expect from the market than the unfolding economic turmoil we are witnessing right now. Moreover, to the extent the AG seeks to rely upon new evidence based upon events that have transpired after the adjournment of the hearing on February 20, 2020, his analysis is self-serving and incomplete. The DCF model relies upon the risk-free rate of return, dividend yields and projected dividend growth rates. Mr. Baudino's use of a stunted dividend growth rate has already been shown to be non-credible and the AG's reliance upon the COVID-19 pandemic's effects upon

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\(^5\) See Roger A. Morin, Ph.D. Direct Testimony, pp. 54-59 (Sept. 3, 2019).

\(^6\) See AG Brief, pp. 7-8, 10.
the risk-free rate of return is unreasonable and myopic. But what is blatantly omitted from the AG’s Brief is any discussion of how dividend yields are also changing rapidly amidst the rapid declines in equity pricing. Using the portions of the DCF that are most likely to yield a result one has already predetermined is not persuasive evidence.

Longer-term financing needs are typically funded by accessing the bank market and the long-term debt and equity capital markets. As the AG’s Brief alludes, the financial markets have experienced significant volatility and periods of illiquidity in the wake of the COVID-19 crisis. In particular, the commercial paper market has experienced significant dislocation with large sums of capital being withdrawn from this market at the same time corporate borrowers, like the Company, have increased needs in accessing this market. Without commercial paper availability, Duke Energy Kentucky’s ability to effectively fund operations on a short-term basis is limited. While other sources of longer-term capital such as the ones listed above can replace commercial paper on a temporary basis, these alternatives typically come at a higher cost of capital when compared to short-term borrowings through commercial paper.

Duke Energy Kentucky is in the midst of a major investment season that is necessary to assure that its: (1) generation assets comply with environmental regulations and wholesale market Capacity Performance rules; and (2) its distribution system continues to serve customers fully and adequately. Access to investor equity is especially important now. No one has disputed this. The

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7 See Peter Eavis, “Why We Are Once Again Rescuing a ‘Safe’ Investment” New York Times (March 19, 2020):

Assets in institutional prime money market funds — in which businesses park their money — have declined by $80 billion, or 12 percent, since March 4, analysts at Barclays wrote Thursday. When big withdrawals occur, the money market funds have to raise cash to pay investors who want to exit. To do that, they try to sell assets to banks, stop investing so much in commercial paper and make fewer short-term “repo” loans to Wall Street banks. The banks use these loans to help finance their huge inventories of stocks and bonds. Companies suddenly lose a source of borrowing, which may prompt them to draw down credit lines they have with banks.
AG’s arguments, though undoubtedly well-meaning, are remarkably short-sighted and would put Duke Energy Kentucky at a distinct disadvantage vis-à-vis other utilities who will continue to command stronger returns precisely because of the ongoing economic crisis.

B. The AG’s Argument that Rate Case Expense Only Benefits Shareholders is Wrong

The AG continues to argue that rate case expense should be allocated in part to shareholders rather than being recognized as a cost of doing business that is recoverable from ratepayers.8 The United States Supreme Court, Kentucky’s highest Court and the Commission have all recognized that rate case expense is an operating expense for a utility,9 just like any other cost of doing business. It is not a unique category of costs that benefits only shareholders, as the AG alleges. Moreover, the AG offers no underlying legal support for this untenable position. Indeed, the Commission previously rejected a former Attorney General’s similar recommendation to allocate rate case expense on a 50/50 basis between shareholders and ratepayers:

In Case No. 95-554, the Commission determined that: “Pursuant to KRS 278.180, a utility has the discretion to choose the timing of its rate case applications. There is nothing in KRS 278 that authorizes the Commission to adopt a disincentive to, in effect, penalize a utility for exercising its right to seek rate relief.” It would be a disincentive to Kentucky-American if its shareholders are denied the opportunity to recover all prudent and reasonable rate case costs. Therefore, the Commission declines to accept the AG’s proposal to share rate case costs.10

8 See AG Brief, pp. 17-18.
9 See Driscoll v. Edison Light & Power Co., 307 U.S. 104, 120–21 (1939) (“Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission.”); City of Lexington v. Pub. Serv. Comm’n of Ky., 249 S.W.2d 760, 763 (Ky. 1952) (“With respect to the item of $48,740 for rate case expense, the cities do not claim that, as a matter of law, rate case expense is not a proper operating expense; their contention is that there is no reference in the record to rate case expense.”), overruled on other grounds by Stephens v. Kentucky Utilities Co., 569 S.W.2d 155 (Ky. 1978); see also In the Matter of Elec. Proposed Adjustment of the Wholesale Water Serv. Rates of Lebanon Water Works, Order, Case No. 2017-00417 (Ky. P.S.C. July 12, 2018) (“A utility may properly recover reasonable rate case expenses as a cost of doing business.”).
Moreover, the AG’s stated concern is that if Duke Energy Kentucky does not have another base rate case in the next five years, the Company’s customers will continue to pay rate case expense.\footnote{See AG Brief, p. 18.} That concern is undercut by the very fact that the Company has not yet even fully recovered the costs of its prior electric rate case. It also should be pointed out that the risk of overpayment is mitigated by the fact that Duke Energy Kentucky proposes to use a five-year amortization period rather than the typical three-year amortization period used by most regulated utilities in Kentucky. The AG’s confiscatory attempt to allocate a portion of rate case expense as an offset to margins is unlawful and unsupported and should be rejected.

C. The AG’s DEBS ADIT Amortization Argument Contradicts His Rate Case Argument

The AG continues to argue that a “one-time credit or refund” of $215,000 is necessary to reflect the excess ADIT balance held by DEBS and that Duke Energy Kentucky’s revenue requirement should be reduced by this amount.\footnote{See id., pp. 27-28.} The Company disputes both the need and the method of the proposed reduction in the revenue requirement. As set forth in Duke Energy Kentucky’s Brief, it would be improper to refund the ADIT amount because the Company has no claim to the ADIT due to a prior tax allocation that favored Duke Energy Kentucky at DEBS’s expense.\footnote{See Jeffrey R. Setser Rebuttal Testimony, p. 5 (Jan. 31, 2020).} Moreover, the AG’s proposal would not result in a “one-time” refund of the amount in question, but an annual refund of that amount. While the AG seeks to amortize the Company’s rate case expense at the most granular level possible to forestall a future potential over-recovery, he inexplicably fails to include an amortization factor into his DEBS ADIT recommendation. Instead, the AG would have the Commission perpetuate a recurring, annual refund of a one-time
credit. If the Commission were to accept the AG’s recommendation – which it should not – it must at least do so in the context of an amortization period equal to the five-year rate case amortization, at a minimum.

D. The AG’s Request to Deny a Carrying Charge on Deferred Customer Connect Development and Implementation O&M Expense Amounts to an Unlawful Confiscation

The AG proposes that the Customer Connect development and implementation O&M expense be deferred,14 and the Company conditionally agreed.15 The AG now asserts that the deferral should not be allowed to accrue a carrying charge, however.16 The AG’s argument is a policy statement, not a legal argument. It lacks any underlying authority and flies in the face of abundant precedent that a utility is authorized to earn a carrying charge on deferred recovery of a legitimate expense.17 The AG’s arguments, if acceded to, would lead to a confiscation of utility property by requiring the Company to make investments while delaying the recovery of the investment and preventing recovery of any return on the investment. The claim that carrying charges should be denied is unsupported and should be denied. Alternatively, the Company should be allowed to recover the full cost of the development and implementation O&M expense projected for the forecasted test year as originally requested.

14 See Lane Kollen Direct Testimony, pp. 25-27 (Dec. 13, 2019).
16 See AG Brief, p. 21.
E. Kroger’s Concern with Anticipated Industrial Load Growth Beyond the Test Year is Premature and has No Application to the Present Case

Kroger’s argument that anticipated future industrial load growth occurring beyond the test year will one day skew the industrial class’s proportion of Company revenues through over-collections is not persuasive. Kroger does not dispute the accuracy of the Company’s test year load forecast. Rather, Kroger worries industrial load growth occurring after the test year will result in additional revenues to the Company from the industrial class, potentially resulting in a situation where Duke Energy Kentucky over-earns from this rate class. Notably, Kroger’s commitment to its own argument is carefully hedged. The dire consequence it loathes is cast in term of, “could cause” and “will likely cause” the Company to over-earn in the years after new rates are put into effect. In short, the outcome Kroger fears is remote and speculative.

The rates in the proposed case are based upon the Company’s anticipated industrial load during the test year, which is the foundational measure of time for purposes of ratemaking. Kroger, however, asks the Commission to take into account load growth that is projected to occur following the test year when allocating test year rates. This would have the effect of improperly mismatching the class allocation of revenues during the test year with energy consumption by class outside the test year. In other words, the very concept of a test year would become so fluid as to

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18 See Kroger Brief, p. 3.
19 See id., pp. 1, 3.
20 See KRS 278.192.
21 See Kroger Brief, pp. 2-3.
22 The Commission has consistently applied the matching principle to assure that rates are based upon the actual test year expense and revenues. See, e.g., In the Matter of: Application of S. Kentucky Rural Elec. Coop. Corp. for an Adjustment of Elec. Rates, Order, Case No. 2011-00096 (Ky. P.S.C. Mar. 30, 2012) (“For ratemaking purposes, the matching principle means that all revenues, expenses, rate base components, plant additions, and capital items are updated to the same period.”); In the Matter of the Rate Adjustment of Louisville Gas & Electric Company, Order, Case No. 1990-00158 (Ky. P.S.C. Jan. 29, 1991) (“The Commission allowed all three adjustments in the December
be essentially meaningless. The practical consequence of Kroger’s remedy would be to guarantee that the current industrial class customers under-pay for electricity – at the expense of other rate classes – in hopes of preventing a potential future scenario where the industrial class customers might over-pay in relation to other customers classes.

Kroger’s fear of beyond test year future over-earning in the industrial class based upon beyond the test year future industrial load growth is speculative and should not be given any credence. Moreover, Kentucky law already affords Kroger a remedy if its worst fears were to materialize at some point in the future. Specifically, Kroger has the ability under KRS 278.260 to challenge the Company’s rates if future events occurring beyond the test year somehow cause Duke Energy Kentucky’s tariffed rate to in fact become unfair, unjust and unreasonable. Until such time when an actual problem materializes, Kroger’s concerns are based upon speculation and conjecture and should be rejected as unpersuasive.

F. The AG’s and Kroger’s Concern Regarding the Omission of Cost Savings Associated with the Fee Free Proposal are Overstated and Unsupported

The AG’s and Kroger’s objection to Duke Energy Kentucky accepting transaction fee free electronic payment methods are based upon the omission of a quantifiable savings to offset the revenue increase associated with the proposal.23 The Company has acknowledged that there will be some nominal cost savings associated with the proposal over the long-term, however, neither Duke Energy Kentucky or any other utility in the United States has been able to precisely quantify these savings on a prospective basis.24 The obvious answer is that the savings will materialize in the ordinary course of business when an equilibrium is reached across all the Company’s payment

21, 1990 Order, but calculated them based on LG&E’s actual investment in Trimble County as of test-year end. By this rate-making treatment, the Commission has consistently adhered to the matching principle.”).
23 See AG Brief, pp. 22-23; Kroger Brief, pp. 3-4.
channels as customers have opportunity to use the payment channel of their choice without penalty relative to using other payment channels. Thus, the net savings and costs of the entire bill collection process naturally present themselves as part of the cost of doing business and will be fully accounted for in the Company’s next base rate case. There is nothing unusual or out of the ordinary about incorporating known and measurable costs into base rates even if associated savings are unknown and unmeasurable.

But despite their objections, neither the AG nor Kroger have themselves been able to identify a single dollar in specific savings the Company will experience by implementing the transaction fee free program. Though they speculate as to the categories of savings that may materialize, they have not identified – even as rife speculation – what those savings might be. It would be unfair to Duke Energy Kentucky’s customers who are currently paying the costs of non-electronic means of bill collection that are already embedded in rates, as well as an additional convenience fee for paying their bills via an electronic payment channel, to continue to do this based upon an elusive savings amount which no Intervenor dares to quantify. Duke Energy Kentucky seeks to be responsive to the single greatest customer complaint it receives. To allow the AG’s and Kroger’s general objections to derail the Company’s specific efforts to be responsive to customers would be patently unfair and unjust. Accordingly, these Intervenors’ objections should be rejected.

G. The Company Continues to Take No Position with Regard to Kroger's Proposed Cost Allocation

The final issue raised in Kroger’s brief relates to rate design. Kroger accepts the Company’s proposed cost allocation in the event that the Commission awards 100% of the rate increase
requested. However, to the extent that the Commission awards less than 100% of the proposed rate increase, Kroger proposes an alternative cost allocation protocol that would serve to reduce the existing rate subsidization of the residential customer class by other rate classes. Duke Energy Kentucky continues to take no position with regard to the merits of Kroger’s proposal.

H. NKU’s Concern with the Storm Deferral is Unfounded

NKU takes issue with the Company’s proposal to include $1 million in base rates for storm restoration expense and simultaneously establish a deferral mechanism to record, accumulate and net assets and liabilities associated with actual storm restoration expenses in between base rate cases. The mechanism is not unlike other trackers that the Commission has authorized in the past and is well within the scope of the Commission’s plenary ratemaking authority to authorize. Moreover, the Commission recently expressed a preference for using this type of rate mechanism in place of a continued reliance upon discreet, sequential deferrals:

EKPC’s current proposal is equivalent to normalization of expenses for financial reporting purposes, similar to that done for ratemaking purposes in a base rates case. While EKPC contends that it may lose the ability to properly reflect the underlying maintenance costs in base rates absent the proposed regulatory asset treatment, normalization of costs that have recurrence cycles of more than one year or that are irregular by their nature is a characteristic feature of ratemaking. Nothing precludes EKPC from including normalized maintenance expenses in either a historic or forecasted test year.... Furthermore, while the exact timing of maintenance activities may not be within EKPC’s ability to foresee, the general rhythmic nature of these costs and the immaterial difference of the costs as a whole compared to EKPC’s historic costs suggest that a base rate case is the more appropriate forum to address these costs.

25 See Kroger Brief, p. 6.
26 See id., p. 6.
27 See NKU Brief, pp. 7-12.
The same logic applies here. Accordingly, NKU’s objections to the normalized storm restoration expense and deferral mechanism with base rate case true-ups should be rejected.

I. The Intervenors’ Remaining Arguments

Each of the remaining arguments asserted in the Intervenors’ Briefs have been addressed in Duke Energy Kentucky’s Brief and the arguments will not be repeated here at length. However, as a convenience, the portions of the Company’s Brief which address the various Intervenors’ arguments are catalogued as follows:

- The AG’s argument relating to calculation of material and supplies, inventories and cash working capital is addressed on pages 16-19 of the Company’s Brief;
- The AG’s requested adjustment to payroll expense is addressed on pages 22-23 of the Company’s Brief;
- The AG’s arguments regarding depreciation expense and recovery of the cost of the depreciation study are addressed on pages 19-20 and 29-31 of the Company’s Brief;
- The AG’s requested confiscatory adjustment relating to the RTEP refund for periods wherein RTEP was paid for by the Company and not customers is addressed on pages 25-28 of the Company’s Brief;
- The AG’s recommendation on terminal net salvage is addressed on pages 32-33 of the Company’s Brief;
- The AG’s thoughts on the service life of the Woodsdale Station are addressed on pages 31-32 of the Company’s Brief;
- The AG’s comments on vegetation management expense are addressed on pages 34-35 of the Company’s Brief.
• The AG’s arguments regarding the residential customer charge are addressed on pages 43-46 of the Company’s Brief;
• The AG’s and NKU’s opposition to the energy storage proposal is addressed on pages 52-55 of the Company’s Brief; and
• The AG’s and NKU’s opposition to the electric vehicle program is addressed on pages 55-61 of the Company Brief.

Those portions of the Company’s Brief cited above are incorporated herein by reference.

III. CONCLUSION

Duke Energy Kentucky’s request for a rate increase is driven in large part by the Company’s projected capital requirement of $700 million during the 2019-2021 period, with approximately $600 million being devoted to capital expenditures and $100 million for debt maturities.30 The Company continues to be judicious in the deployment of capital, acting in accordance with Kentucky law and the Commission’s guidance as to when Certificates of Public Convenience and Necessity are required and being responsive to the needs and expectations of customers. The investment is also driven by the relative economic growth taking place throughout the Company’s service territory, which is itself fueled in part by the Company’s historically low rates when compared to other regulated utilities. Duke Energy Kentucky’s rate request strikes the right balance and will allow the Company to continue to provide adequate, efficient and reliable service at fair, just and reasonable rates. The Application should be approved as set forth therein.

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky respectfully requests the Commission to grant the relief prayed for in the Company’s March 16, 2020 Brief.

30 See Christopher M. Jacobi Direct Testimony (Jacobi Direct), pp. 13-14 (Sept. 3, 2019); see also See Duke Energy Kentucky Response to Staff Post-Hearing-DR-01-012.
This 20th day of March 2020.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that the foregoing electronic filing is a true and accurate copy of the document being filed in paper medium; that the electronic filing was transmitted to the Commission on March 20, 2020; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that a copy of the filing in paper medium is being delivered within thirty days of the lifting of the ongoing COVID-19 pandemic state of emergency.

Counsel for Duke Energy Kentucky, Inc.