COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

THE ATTORNEY GENERAL'S POST-HEARING BRIEF

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ATTORNEY GENERAL'S POST-HEARING BRIEF

The intervenor in this proceeding, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"), submits the following for his post-hearing brief in the above-styled matter.

I. STATEMENT OF THE CASE

Duke Energy Kentucky, Inc. ("DEK" or the "Company") is an investor owned utility, which provides both gas and electric service. DEK purchases, sells, stores, and transports natural gas in Boone, Bracken, Campbell, Gallatin, Grant, Kenton, and Pendleton Counties, Kentucky.[1] DEK generates, distributes and sells electricity in Boone, Campbell, Grant, Kenton, and Pendleton Counties to 142,394 customers.[2] On August 1, 2019 DEK filed its Notice of Intent to File its application for, *inter alia*, an increase to its electric base rates, new tariffs, and other relief. DEK subsequently filed its application on September 3, 2019. On September 9, 2019, the Commission found that the application met the minimum filing requirements and accepted it for filing as of September 3.[3]

[1] Application [Application], *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, at 2 (Ky. Commission September 3, 2019).
[2] *Id.*; DEK 2018 Annual Report, at 3, 5.
[3] No Deficiency Letter, Case No. 2019-00271 (Ky. Commission September 9, 2019).

DEK utilized a Fully Forecasted Test Year ending March 31, 2021, and initially proposed an increase to its electric base rates of $45.6M, which would result in a new total revenue requirement of $356.9M.[4] DEK's overall revenue increase, including riders, amounts to 12.54%.[5] The bill impact of DEK's proposed increase for residential customers would be approximately 16.2%, or $15.62 for the average residential customer using 1,000 kWh of electricity per month.[6] DEK also proposed a $3.00 increase to its residential customer charge, from $11.00 to $14.00.[7] DEK filed its Base Period Update on January 14, 2020.[8] Shortly thereafter, in rebuttal testimony, DEK revised its proposed base rate increase to $44.222M.[9]

Three parties were granted intervention: the Attorney General, the Kroger Co. ("Kroger"), and Northern Kentucky University ("NKU"), while two other parties, Zeco Systems, Inc. d/b/a Greenlots and Chargepoint, Inc. were denied intervention.[10] The Commission held a two-day evidentiary hearing in this matter, on February 19th and 20th, 2020. The Attorney General recommends that the proposed rates be denied, and that rates be reduced according to the following arguments. Furthermore, the Attorney General recommends that the Commission deny the proposed increase to the residential customer charge.

II. ARGUMENT

A. *Return on Equity*

The Attorney General's expert witness for return on equity, Mr. Richard Baudino, recommended in his Direct Testimony that the Commission award DEK a return on equity

[4] Application, at 5.
[5] Direct Testimony of Jeff L. Kern [Kern Direct], at 6 (Ky. Commission September 3, 2019).
[6] Application, at 5.
[7] Kern Direct at 9.
[8] DEK Base Period Update (Ky. Commission January 14, 2020).
[9] Rebuttal Testimony of Sarah E. Lawler [Lawler Rebuttal], at 27 (Ky. Commission January 31, 2020).
[10] *See* Order, Case No. 2019-00271 (Ky. Commission October 2, 2019); and Orders, Case No. 2019-00271 (Ky. Commission October 14, 2019).

("ROE") of 9.0%,[11] in contrast to DEK's originally requested 9.8%.[12] Mr. Baudino summarized his conclusions and recommendations as follows:

> Based on current financial market conditions, I recommend that the [Commission] adopt a 9.0% return on equity for DEK in this proceeding. My recommendation is based primarily on the results of a Discounted Cash Flow ("DCF") model analysis. My DCF analysis incorporates my standard approach to estimating the investor required return on equity and utilizes the proxy group of 20 companies used by DEK witness Dr. Morin.
>
> My cost of equity analyses also include Capital Asset Pricing Model ("CAPM") analysis for additional information to inform my recommendation to the Commission. I did not incorporate the results of the CAPM in my recommendation given the very low cost of equity results being produced by this model at this time. Nonetheless, the CAPM helps confirm the fact that the required ROE for regulated electric utilities continues to be relatively low given the low interest rate environment that has prevailed in the economy for the last 10 or so years.[13]

As he stated, Mr. Baudino primarily relied on the results of a DCF model analysis using the same proxy group employed by Dr. Morin, which is a reasonable basis upon which to estimate the return required for investors for the Company, which itself is not publicly traded.[14] Mr. Baudino also employed CAPM analyses, which used both historical and forward-looking data, "the results from [which] tend to support the reasonableness of [his] recommendation."[15]

The basic DCF approach is based in valuation theory, "on the premise that the value of a financial asset is determined by its ability to generate future net cash flows."[16] The DCF model has been consistently accepted by the Commission.[17] The CAPM approach theorizes that "investors, through diversified portfolios, may combine assets to minimize the total risk of the

[11] Direct Testimony of Richard A. Baudino [Baudino Direct], at 3, 31–32 (Ky. Commission December 13, 2019).
[12] Direct Testimony of Roger A. Morin, PhD [Morin Direct], at 4, 7 (Ky. Commission September 3, 2019)
[13] Baudino Direct at 3.
[14] *Id*. at 17.
[15] *Id*.
[16] *Id*.
[17] *See generally* Commission Case Nos.: 2018-00294, 2018-00295, 2018-00281, 2018-00358, 2017-00321, 2017-00179, 2016-00370, 2016-00371.

portfolio … [so] that diversified investors are rewarded with returns based on market risk."[18] There is disagreement, however, regarding the use of the CAPM method and its accuracy in estimating expected returns, as Mr. Baudino explained in his testimony, especially due to its reliance on beta to determine the risk of any security.[19] Evidence suggests that beta coefficients only measure a fraction of total investment risk.[20] Thus, Mr. Baudino relied primarily on his DCF analysis.[21]

In determining his DCF recommendation, Mr. Baudino used the average DCF ROE results from his analysis, which were 8.48 percent and 8.52 percent, then considered the top end of his DCF range, which was 9.45 percent.[22] His recommended 9.0% is near the midpoint of that range, and in his expert opinion "represents a reasonable estimate for the investor required ROE for DEK in this case."[23] Mr. Baudino also accepted the Company's proposed capital structure,[24] which "is comprised of 51.8 percent debt and 48.2 percent equity, after making adjustments for purchase accounting and other items."[25]

DEK originally requested a 9.8% return on equity ("ROE"), which it then revised to 9.7% in rebuttal testimony.[26] The Company's expert witness for return on equity, Dr. Roger A. Morin, Ph.D., characterized the original 9.8% recommendation as "highly conservative and barebones", and both recommendations as the "minimum" requirement for DEK in terms of ROE, suggesting that an even higher return on equity is warranted.[27] Dr. Morin went on to cite DEK's elevated risk profile, due in part to its small size, ongoing construction projects, and its lack of diversity in its

[18] Baudino Direct at 22.
[19] *Id*. at 24.
[20] *Id*. at 24.
[21] *Id*. at 3.
[22] *Id*. at 32.
[23] *Id*. at 31–32.
[24] *Id*. at 32.
[25] Direct Testimony of Christopher M. Jacobi [Jacobi Direct], at 9 (Ky. Commission September 3, 2019).
[26] Morin Direct at 4, 7; Rebuttal Testimony of Roger A. Morin [Morin Rebuttal], at 36 (Ky. Commission January 31, 2020).
[27] Morin Direct at 60–61; Morin Rebuttal at 36.

generation fleet, for preferring a higher ROE.[28] Mr. Baudino disagreed with this characterization of DEK's risk, noting that it is a low-risk regulated electric utility.[29] As Mr. Baudino explained, DEK's ability to file rate cases based on forecasted test years mitigates regulatory lag associated with ongoing construction that is not yet in service, and it would be wholly unfair to ask ratepayers to pay an inflated ROE to account for projects not yet deemed used and useful by the Commission.[30] As to DEK's size, Mr. Baudino noted that the average beta for his proxy group of regulated utility companies is 0.60, much lower than the betas of mid-level, low, and micro-capitalization groups of stocks studied by Duff and Phelps, confirming that a regulated utility is a much less risky investment.[31] Additionally, any additional risk resulting from the Company's lack of diversity in its generation mix "would have been factored into the Company's current credit ratings, which are A-/Baa1."[32] As Mr. Baudino further pointed out in his Direct Testimony, DEK's credit ratings are consistent with the average S&P credit rating for the electric utility industry as measured by the Edison Electric Institute.[33]

In a recent final order to an investor-owned electric utility rate case, the Commission acknowledged the prevailing national economic conditions and established the context through which it would approach ratemaking in the next few years, opining "models supporting the low interest rate environment should be given more weight than those supporting high interest rate expectations."[34] In setting DEK's ROE in its last electric rate case, the Commission agreed that

[28] Morin Direct at 61–63; Morin Rebuttal at 29–31.
[29] Baudino Direct at 3–4.
[30] *Id*. at 42.
[31] *Id*. at 42–43.
[32] *Id*. at 43
[33] *Id*. at 15.
[34] Final Order, *Electronic Application of Kentucky Power Company for (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2017 Environmental Compliance Plan; (3) An Order Approving its Tariffs and Riders; (4) An Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities; and (5) An Order Granting All Other Required Approvals and Relief*, Case No. 2017-00179, at 28 (Ky. Commission Jan. 18, 2018).

financial markets were still in a low-interest rate environment, but pointed to healthier economic data and outlook for the national economy, the Federal Reserve's increasing the federal funds rate to 1.75 percent, and the possibility of further interest rate increases as justification for awarding the Company a 9.725 percent ROE.[35] Since that Order, in 2019, the Federal Reserve cut the federal funds rate three separate times for a total of 75 basis points.[36] On March 3, 2020, the Federal Reserve announced that it was cutting the federal funds rate by 50 basis points, with a target range between 1 percent – 1.25 percent. It is clear that a low-interest rate environment persists. DEK has provided no evidence or argument to persuade the Commission to change course from continuing to adopt this view of the economic landscape.

Dr. Morin's recommended DCF results ranged from 8.91% – 10.0%.[37] Dr. Morin's analysis included calculations based on forecasted interest rates,[38] which he confirmed at the hearing.[39] In his direct testimony, Dr. Morin relied upon a forecast for the U.S. Treasury 30-year long-term bond yield at 4.2%, which he then revised in rebuttal testimony in reliance upon an updated forecast for the same bond yield at 3.9%.[40] At the hearing, Dr. Morin acknowledged that the current yield for the 30-year U.S. Treasury bond was approximately 2.1%,[41] but he stressed that investors often base their decisions upon forecasts.[42] Since then, the Treasury bonds have fallen dramatically, with the 30-year yield at 0.99% as of March 9, 2020.[43] Dr. Morin also recommended

[35] Final Order, *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, at 39 (Ky. Commission April 13, 2018).
[36] Baudino Direct at 3–4.
[37] *Id*. at 34; Morin Direct at 31.
[38] Morin Direct at 36–37.
[39] Video Transcript Evidence ["VTE"], February 19, 2020, at 9:27:30 — 9:33:30.
[40] Morin Direct at 35–36, 39; Morin Rebuttal at 34.
[41] VTE, February 19, 2020, at 9:27:30 — 9:33:30.
[42] *Id*.
[43] Board of Governors of the Federal Reserve System, *H.15 Selected Interest Rates*, (March 10, 2020) https://www.federalreserve.gov/releases/h15/.

the Commission adopt his forecasted interest rates in DEK's last rate case, using a 30-Year Treasury bond yield of 4.4%, which never materialized.[44] Current low bond yields simply do not support Dr. Morin's use of an excessively high 30-Year Treasury bond yield.

In contrast, Mr. Baudino employed current interest rates, which reflect the prevailing sentiment that a low interest rate environment has been the status quo for the national economy for approximately the last 10 years.[45] Furthermore, the Federal Reserve's lowering of short-term interest rates three times in 2019, suggests that interest rates will remain low through 2020 and cuts against Dr. Morin's reliance on forecasts predicting elevated interest rates in the near future.[46] The effect of Dr. Morin using forecasted interest rates at a level much higher than they are currently, despite indications that they will stay low, is to artificially inflate his estimated ROE. In his Direct Testimony, Mr. Baudino addressed Dr. Morin's argument regarding investor expectations regarding interest rates' future direction stating "[s]ecurity markets are efficient and most likely reflect investors' expectations about future interest rates … Moreover, the current low interest rate environment still favors lower risk regulated utilities."[47] Consequently, Dr. Morin's recommendation, the original 4.2% and the revised 3.9% forecasted interest rate, "fails to properly reflect investor expectations in today's market. It results in inflated results for his CAPM, ECAPM, and historical risk premium studies."[48] As Mr. Baudino quoted in his testimony, Dr. Morin himself wrote in his treatise, that regarding the "extensive literature concerning the prediction of interest rates … it appears that the no-change model of interest rates frequently provides the most accurate of forecasts of future interest rates."[49]

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[44] Case No. 2017-00321, Direct Testimony of Roger A. Morin, PhD, at 32 (Ky. Commission September 1, 2017).
[45] Baudino Direct at 3–4, 11–12, 14, 33.
[46] *Id*. at 3–4.
[47] *Id*. at 11.
[48] *Id*. at 38.
[49] *Id*. at 11 (quoting Roger A. Morin, *New Regulatory Finance*, Public Utilities Reports, Inc. (2006) at 279.)

The Commission recently rejected the use of forecasted rates in the recent base rate case of Atmos Energy Corporation stating "the Commission believes that in this current economic and low-interest rate environment, forecasted interest rates are not reliable and the best estimate is the most current interest rates."[50] The Commission affirmed this stance in Kentucky-American Water Company's recent rate case opining that:

> [r]ates have been forecasted to increase for several years, and, at one point, forecasted to increase two times in 2019. However, the Federal Reserve Board changed its stance, decided to adopt a wait and see approach, and revised policies that were set just a short time prior. Therefore, the Commission continues to view forecasted interest rates as unreliable and frequently inaccurate and supports models that utilize current interest rates and data.[51]

With this understanding that forecasts are often just wrong, Mr. Baudino correctly points out that if investors do consider forecasted interest rates at all, they are already baked into current securities prices.[52] The Attorney General supports the use of current interest rates, as they are known and measurable, and urges that the Commission adhere to its recent precedent of rejecting forecasted interest rates.

Dr. Morin also employed an upward adjustment due to his use of flotation costs in his analysis.[53] Mr. Baudino disagrees with the inclusion of a flotation cost adjustment which is intended to capture the costs of issuing common stock, and may include legal, accounting, and printing costs in addition to broker fees and discounts. Mr. Baudino stated in his testimony that "it is likely that flotation costs are already accounted for in current stock prices and that adding an adjustment for flotation costs amounts to double counting."[54] Likewise, the Commission has

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[50] AG Exhibit 1, Final Order, Case No. 2018-00281, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates*, at 44 (Ky. Commission May 7, 2019).
[51] Final Order, Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, at 64 (Ky. Commission June 27, 2019).
[52] Baudino Direct at 36.
[53] Morin Direct at 54–59.
[54] Baudino Direct at 34.

consistently disallowed the inclusion of flotation costs in the calculation of ROE, opining "[t]he Commission has not altered its opinion regarding flotation costs and agrees with the Attorney General that flotation costs should be excluded from the ROE analysis."[55] Dr. Morin even agreed that the Commission has traditionally disallowed flotation costs in cross-examination.[56] Mr. Baudino noted that if flotation costs are excluded from Dr. Morin's discounted cash flow ("DCF") analysis, his ROE results range from 8.75% – 9.83%.[57] The Attorney General believes flotation costs should be excluded from the ROE analysis and that DEK has offered no evidence or argument which should persuade the Commission to deviate from its practice of excluding it as well.

Further differences between Dr. Morin's and Mr. Baudino's analyses are due to Dr. Morin's rejection of forecasted dividend growth, and his expressing concern that slower dividend growth in the near term did not reflect long-term expected earnings growth, citing studies supporting earnings growth forecasts "as superior proxies for investor expected growth."[58] But as Mr. Baudino asserted, the Value Line forecasted dividend growth rate for those companies in the proxy group "are not at all out of line with the earnings growth forecasts from Value Line, Zacks, and Yahoo! Finance." If credible dividend forecasts are available, then their inclusion in the DCF model is warranted.[59] Dr. Morin also used 1 + g to calculate the expected dividend yield in his DCF calculation. In contrast, Mr. Baudino used 1 + .5*g to calculate the expected dividend yield using the DCF model. The 1 + .5*g approach applies "one-half of the expected growth rate to the current quarterly dividend recogniz[ing] that the investor may not actually receive a full year of increased dividend payments from the time the DCF calculation was made."[60]

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[55] AG Exhibit 1, Final Order, Case No. 2018-00281, at 42–43 ; *See also* Final Order, Case No. 2017-00321, at 39–41.
[56] VTE at 9:27:30 — 9:33:30 (Referencing AG Exhibit 1, Final Order, Case No. 2018-00281, at 42–43).
[57] Baudino Direct at 34.
[58] *Id*. at 33 (referring to Morin Direct at 23–24).
[59] *Id*. at 35.
[60] *Id*. at 36.

During the Company's cross-examination of Mr. Baudino, much was made of recently awarded ROEs for other electric utilities and the average awarded in 2019 for certain utility segments.[61] As Mr. Baudino stated, the ROE awarded to other utilities, while a consideration, should not be the determining factor for this Commission awarding an ROE.[62] As already discussed, there are other variables that the Commission must consider. If this Commission relied solely on the average, the ROE would never move. Furthermore, the Kentucky Supreme Court has opined "one of the important objectives considered by the commission … is providing the lowest possible cost to the ratepayers."[63]

Mr. Baudino's ROE recommendation accurately reflects the low-interest rate environment of the current market as opposed to than that of Dr. Morin. Mr. Baudino's recommended ROE is based on calculations using current interest rates and without incorporating flotation costs, which both adhere to established Commission precedent. Mr. Baudino's recommendation also employs the DCF model, used by Dr. Morin,[64] and which is consistently accepted by the Commission.[65] Thus, the Attorney General recommends the Commission exclude flotation costs, use current interest rates, and use the DCF model.

The Attorney General recommends the Commission lower DEK's ROE to 9.0%. The revenue requirement effect of adopting a 9.0% return on equity results in a reduction to the base revenue requirement of $4.761M, as noted in Mr. Kollen's direct testimony.[66]

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[61] VTE at February 19, 2020, at 9:37:52 — 10:25:15; 10:42:50 — 10:45:00.
[62] *Id.*; *See also* Baudino Direct at 32.
[63] *Public Service Comm'n of Kentucky v. Continental Telephone Co. of Kentucky*, 692 S.W.2d 794, 799 (Ky. 1985).
[64] Morin Direct at 4, 18–31.
[65] *See generally* Commission Case Nos.: 2018-00294, 2018-00295, 2018-00281, 2018-00358, 2017-00321, 2017-00179, 2016-00370, 2016-00371.
[66] Direct Testimony of Lane Kollen [Kollen Direct], at 5 (Ky. Commission December 13, 2019).

B. *The Attorney General's Other Revenue Requirement Adjustments*

1. Rate Base Issues

a. Accumulated Deferred Income Taxes

As described by Mr. Kollen in his testimony, DEK forecast the per books Accumulated Deferred Income Taxes ("ADIT") balances by account and temporary difference, including the effects of plant additions through the test year, then removed certain ADIT balances from rate base. DEK incorrectly failed to remove the Other Noncurrent After-Tax Deferred Tax Asset ("DTA") for Solar ITC from its rate base and initially proposed recovery of expenses related to it. In response to a data request from the Attorney General,[67] and in rebuttal testimony,[68] the Company accepted Mr. Kollen's adjustment to remove the Other Noncurrent After-Tax DTA for Solar ITC from rate base. The effect of this adjustment is a $3.017M reduction in rate base and a $0.250M reduction in the revenue requirement. The Attorney General recommends the Commission accept this adjustment.

b. Fuel and Materials and Supplies Inventories

i. Vendor Financing of Fuel Inventories and Materials and Supplies Inventories

DEK is not entitled to earn a return on or include in rate base costs that it did not finance. As Mr. Kollen described, DEK included $19.518M in fuel inventories and $18.759M in materials and supplies ("M&S") inventories in rate base.[69] DEK did not offset the fuel and M&S inventories with the related accounts payables to account for the portion of each inventory which is financed by its vendors and not its investors or customers.[70] This practice was recognized through past DEK

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[67] DEK Response to AG-DR-2-5.
[68] Lawler Rebuttal at 23, 27.
[69] Kollen Direct at 7–11 (referring to Application, Schedule B-5).
[70] *Id*.

cases by its use of a lower capitalization for the return on component of the revenue requirement. The Company has filed this case utilizing rate base in lieu of capitalization, which does not implicitly recognize vendor financing in the same manner, but requires the Company to make explicit adjustments to rate base to remove the portions of the fuel and M&S inventories that are being financed by DEK's vendors.

Thus, Mr. Kollen recommends that the Commission reduce rate base for the accounts payable related to the fuel inventories and M&S inventories. The effect of Mr. Kollen's adjustment is a $2.258M reduction in rate base related to the fuel inventories accounts payable, and a $0.187M reduction in the revenue requirement. The Attorney General recommends the Commission accept this adjustment.

ii. Customer Financing of Materials and Supplies Inventories

The Company did not reduce rate base for the customer financing of M&S inventories.[71] DEK included cash working capital based on one-eighth of the non-fuel O&M expense. This O&M expense includes material and supplies expense, which in turn means that the cash working capital includes one-eighth of this materials and supplies expense in rate base. As Mr. Kollen explains, the Company has effectively included M&S inventories in rate base as a separate component of rate base without an offset for the M&S inventories, which are also included in case working capital in the rate base.[72] Again, the Company "should earn a return on M&S inventories only to the extent that they are not financed by its vendors or by its customers in another component of rate base in the revenue requirement formula."[73] The transition to rate base in lieu of capitalization in determining the Company's return has created "overlap" issues, which the Commission should

[71] *Id*. at 9.
[72] *Id*.
[73] *Id*. at 10.

address to make sure that DEK is not earning dual returns on the same M&S inventories.

If the Commission adopts Mr. Kollen's recommendation to set cash working capital at $0,[74] then there is no effect to the revenue requirement.[75] In the alternative, if the Commission does not accept Mr. Kollen's adjustment to cash working capital, then he recommended that the Commission reduce the M&S inventories remaining after the reduction for the Company's vendor financing to $0.[76] The effect of this reduction in rate base is a $1.478M reduction in the revenue requirement.[77] The Attorney General recommends the Commission accept the adjustment to set cash working capital. Alternatively, the Attorney General recommends that the Commission accept the adjustment to M&S inventories.

c. Cash Working Capital

The Company's request to include $14.965M in cash working capital in rate base should be denied.[78] The Company relied on the outdated method of calculating its cash working capital by simply using one-eighth of its forecast non-fuel O&M expense, which produces a hypothetical amount that is both inaccurate and usually inflated.[79] Instead, the Company should have used the more accurate lead/lag approach to calculating cash working capital, which "measures the number of lag days in revenue cash receipts and the number of lag days in expense cash disbursements and then weights the daily revenue and expense amounts using the lag days to calculate the net investor (positive) or customer (negative) cash working capital investment."[80] This method rests on the faulty assumption that investors provide and finance cash working capital equal to exactly one-

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[74] *See infra* section c. Cash Working Capital.
[75] Kollen Direct at 10.
[76] *Id*.
[77] *Id*.
[78] *Id*. at 11 (referring to Application, Schedule B-5).
[79] *Id*. (referring to Application, WPB-5.1a).
[80] *Id*.

eighth of the utility's actual non-fuel O&M expense.[81] This method also treats as the same a utility that sells its receivables to a third party, and one that does not. The former can convert its receivables to cash very quickly, and sees very little revenue lag, while the latter may wait 30–40 days to receive payments from customers and be able to convert those receivables to cash.[82] The inflated cash working capital amount produced by the one-eighth non-fuel O&M expense method is further exacerbated when applied to a utility that sells its receivables.[83]

DEK does in fact sell its receivables, as do its sister affiliates Duke Energy Ohio and Duke Energy Indiana, to another affiliate, Cinergy Receivables, L.L.C.[84] DEK is able to accelerate the sale of and conversion into cash of those receivables at minimal cost through this affiliate relationship, thereby minimizing its revenue lag days.[85] As a result of this substantial reduction in revenue lag, DEK's cash working capital calculated under the lead/lag approach would likely be net negative, with "revenue lag less than expense lag for all cash and non-cash expenses, except those that involve prepayments."[86] In rebuttal, the Company defended its use of the one-eighth non-fuel O&M expense as a long-standing practice, and pointed to the method's historical acceptance by the Commission.[87] However, the one-eighth non-fuel O&M method does not envision a Company being able to sell its receivables in an interval as short as DEK does, which results in extremely short revenue lag days. Moreover, this is the first time the Company has used rate base to calculate the return component of the revenue requirement calculation in an electric base rate case, making this issue a case of first impression for the Commission.[88]

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[81] *Id*. at 12.
[82] *Id*.
[83] *Id*.
[84] *Id*. at 15–16; DEK Response to AG-DR-2-24, Confidential Attachment 1.
[85] Kollen Direct at 16.
[86] *Id*. at 17.
[87] Lawler Rebuttal at 7–9.
[88] Kollen Direct at 17.

As Mr. Kollen discussed, the Commission has recently adopted the lead/lag approach in lieu of the one-eighth non-fuel O&M method in recent rate cases of Atmos Energy Corporation and Kentucky-American Water Company.[89] Mr. Kollen recommended that the Commission set the Company's cash working capital to $0, and direct the Company to perform and file a cash working capital study using the lead/lag approach in both its next electric and gas base rate proceedings. The Attorney General recommends the Commission accept this adjustment.

d. Regulatory Asset for Deferred Rate Case Expense

The Company proposed to amortize $0.949M as a regulatory asset over five years for rate case expenses in both this case and the unamortized rate case expenses in prior electric rate cases.[90] The forecast rate case expenses for the instant case include $0.060M for DEK's depreciation study.[91]

The rate case expenses were incurred, and will be incurred to benefit Duke Energy, the parent company of DEK, and its shareholders. DEK itself has no shareholders. Those expenses were and will not be incurred to benefit DEK's customers. Additionally, the Company's revenue requirement reduces each year as the regulatory asset is amortized and the rate base similarly declines.[92] However, there is no benefit to DEK customers from this cost reduction until base rates are reset in the future, and the revenue recovery set in this case will continue at the same rate despite the decline in rate base and is never trued-up.[93] If DEK does not come back in for a rate case within five years, it will continue to recover the amortization expense even though the

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[89] *Id*. at 14–15 (citing Order, Case No. 2017-00349, at 16–17 (Ky. Commission May 3, 2018)); and Order, Case No. 2018-00358, at 3–8 (Ky. Commission June 27, 2019).
[90] Kollen Direct at 18 (referring to Application, Schedule F-6, WPF-6a).
[91] *Id*. (referring to Schedule F-6).
[92] *Id*. at 20.
[93] *Id*.

regulatory asset has been fully amortized, and customers continue to miss out on the cost reductions through the lack of a true up of the revenue recovery.[94]

Thus, Mr. Kollen recommended that the Commission "allocate the amortization expense to DEK's customers as a form of sharing between Duke Energy shareholders and DEK's customers. Over five years, this will allocate approximately 15% of the total revenue requirement to Duke Energy and approximately 85% to DEK's customers." Mr. Kollen further recommended that the Commission disallow the costs of the deprecation study, due to the fact that seeking new depreciation rates two years after they were last set is unduly aggressive and not necessary.[95] Mr. Kollen also recommended that the Commission exclude DEK's regulatory asset for deferred rate case expenses from rate base. The effects of this recommendation are a $0.059M reduction in the revenue requirement to remove the return on the rate base, and $0.012M to remove the amortization expense for the cost of the depreciation study.[96] The Attorney General recommends the Commission accept this adjustment.

2. Operating Income Issues

a. DEK and DEBS Payroll Expense and Related Payroll Tax Expense

DEK forecasted an increase in its test year payroll expense far over and above the 2019 actual payroll expense, an over 9% increase.[97] However, the budgeting and forecasting methodology employed by the Company varies substantially even throughout the service company, Duke Energy Business Services, LLC ("DEBS").[98] In making this forecast, DEK does not distinguish between full-time equivalent employees ("FTEs") and contractors, which are

[94] *Id*.
[95] *Id*. at 19–20.
[96] *Id*. at 20–21.
[97] *Id*. at 23; LK-10 (DEK Response to AG-DR-2-39, with Attachment).
[98] Kollen Direct at 21.

sometimes referred to as "contingent" employees.[99] Mr. Jacobi confirmed that DEK does not budget FTEs by headcount, and does not rely on actual payroll costs for each FTE.[100] Mr. Jacobi also confirmed what the Company admitted in discovery, that it had inadvertently excluded the actual data sets from certain 2019 budget accounts,[101] making it all but impossible for Mr. Kollen to accurately verify DEK's FTE count. Without budgeting by headcount or payroll expense, it is difficult to see how DEK could actually forecast its payroll expense with any accuracy.[102]

The Company's forecast of 2020 payroll costs is an increase of 9.2% over the actual payroll costs of 2019.[103] Such an increase would be excessive, especially since Mr. Jacobi assumed union labor cost increases will fall within a 1–3% range, while non-union labor costs were assumed to be set at 3.5%.[104] As Mr. Kollen noted, wages for employees represented by the International Brotherhood of Electrical Workers are due to increase by 3.0% effective April 1, 2020, and those for the Utility Workers of America are due to increase 2.5% effective April 1, 2020.[105] The employees represented by these two unions comprise 90% of the Company's total payroll cost.[106]

Mr. Kollen recommended that the Commission use the most recent actual monthly payroll expense and escalate it by 3.0% annually for the test year, assuming no change in average FTEs, consistent with DEK's policy of maintaining a flat headcount.[107] The effect of Mr. Kollen's recommendation is a $1.125M reduction in payroll expense, a $1.127M reduction in the revenue requirement, and a $0.086M reduction in payroll taxes expense and the revenue requirement related to the reduction in payroll expense. The Attorney General recommends the Commission

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[99] *Id*.
[100] DEK Response to AG-DR-2-37(a); VTE, February 19, 2020, at 15:38:20 — 15:49:52.
[101] DEK Response to AG-DR-2-39.
[102] Kollen Direct at 22.
[103] *Id*. at 23.
[104] Jacobi Direct at 21.
[105] Kollen Direct at 23–24 (citing Direct Testimony of Renee Metzler at 16–17).
[106] *Id*. (citing DEK's Public Unredacted Response to Staff-DR-1-41).
[107] *Id*. at 24.

accept this adjustment.

b. Customer Connect Development and Implementation Operation and Maintenance Expense

DEK initially proposed the recovery of $0.908M in Operations & Maintenance ("O&M") expense related to the development and implementation of Customer Connect, the Company's new customer information system ("CIS"), in the revenue requirement.[108] Additionally, DEK included $1.342M in rate base for Customer Connect capital expenditures that have been closed to plant in service, net of accumulated depreciation and ADIT; $0.068M in related depreciation expense; and $0.012M in related ad valorem tax expense.[109]

Customer Connect is expected to provide additional functionality, increased efficiency, and achieve economies by being the only CIS used by all Duke Energy regulated utilities, thereby avoiding the downtime incurred with the current CIS. However, the new CIS system is not expected to be fully operational until September 2022.[110] Since the development and implementation expenses for Customer Connect are one-time and nonrecurring, and they have future value, Mr. Kollen recommended that the Commission remove the development and implementation O&M expenses from the revenue requirement and direct the Company to defer those expenses as a regulatory asset.[111] This future value makes the O&M costs similar to the capital expenditures included in construction work in progress and plant in service, while the fact that a portion of the costs will continue being expensed is down to specific accounting requirements for software development and implementation costs found in generally accepted

[108] Kollen Direct at 25 (citing LK-11: DEK Response to AG-DR-1-7).
[109] *Id*. (citing LK-12: DEK Response to AG-DR-1-7).
[110] Direct Testimony of Retha Hunsicker [Hunsicker Direct], at 2–7, 22 (Ky. Commission September 3, 2019); Direct Testimony of Amy B. Spiller [Spiller Direct] at 23 (Ky. Commission September 3, 2019); VTE, February 19, 2020 at 13:49:33 — 13:53:06.
[111] Kollen Direct at 26–27.

accounting principles ("GAAP").[112] Mr. Kollen further recommended that the regulatory asset be included in rate base and then amortized using the same service life used for the depreciation rate applied to the plant costs in the next base rate proceeding.[113]

In rebuttal testimony, DEK agrees with Mr. Kollen's recommendation to include the costs in rate base:

> only if regulatory asset authority is granted by the Commission to allow the Company to accumulate all actual O&M expenses, including carrying costs, associated with the Customer Connect program incurred (beginning with those incurred during the test period in this case) into a regulatory asset. Once the actual costs for the project are incurred and the actual amount of the regulatory asset is known, the Company will request recovery in a subsequent rate proceeding.[114]

The Company also agreed with Mr. Kollen's recommendation to include this regulatory asset in rate base in that subsequent rate proceeding with an amortization period equal to the service life used for the depreciation rate applied to the capital costs. However, DEK's rebuttal proposal included conditions with which the Attorney General does not agree. Mr. Kollen's recommendation to defer the cost as a regulatory asset necessarily discontinues additional accounting deferrals after the new CIS software is placed into service, since it is a one-time nonrecurring cost.[115] The Company did not indicate whether it agrees with this. The Attorney General does not agree that DEK should recover carrying costs on the regulatory asset. Moreover, though DEK has not stated so, the Attorney General is against any plans it may have to defer depreciation expense after the Customer Connect software is placed into service and closed to plant in service.

The effect of Mr. Kollen's recommended adjustment is a reduction of $0.911M to the

[112] *Id*.
[113] *Id*. at 24–27.
[114] Lawler Rebuttal at 24, 27.
[115] Kollen Direct at 27.

revenue requirement. The Attorney General recommends the Commission accept this adjustment.

c. Credit/Debit Card and Electronic Check Payment Convenience Fees

The Company proposed to remove the convenience fees charged to individual residential customers who opt to pay by credit card, debit card, or electronic check, and instead socialize this expense by requiring all customers to pay for this as an operating expense.[116] The Company estimated the convenience fee expense to be $0.493M for the test year,[117] which is based on a projection from the vendor that these forms of payment will grow in the first year without a convenience fee per individual transaction.[118] Ms. Spiller testified that this proposal would not affect any of DEK's current in person payment locations.[119]

Ms. Quick testified that the entirety of the $1.50 per transaction convenience fee goes to SpeedPay, DEK's payment vendor.[120] Ms. Quick stated that the Company did not perform any formal or informal polling or surveys of residential customers to gauge their support for this proposal.[121] According to Ms. Quick, approximately 25% of DEK customers currently pay by credit or debit card,[122] and the convenience fee is one of the top complaints of customers despite their otherwise overall satisfaction with the billing experience.[123] DEK also admitted that cost savings through reduction of certain other expenses such as payment processing expense, call center expense, uncollectible account expense, and interest expense would be achieved through this proposal, but did not reflect any such savings in the test year stating "the impact, if any, is not

[116] *Id*. at 27–28 (referring to Direct Testimony of Lesley G. Quick [Quick Direct], at 8–10 (Ky. Commission September 3, 2019)).
[117] *Id*. at 28 (referring to Direct Testimony of Sarah E. Lawler [Lawler Direct], at 12 (Ky. Commission September 3, 2019).
[118] VTE, February 19, 2020 at 11:55:15 — 12:01:00.
[119] VTE, February 19, 2020 at 8:43:25 — 8:49:43.
[120] VTE, February 19, 2020 at 11:55:15 — 12:01:00.
[121] *Id*.
[122] *Id*.
[123] *Id*.; Quick Direct at 10–11; Spiller Direct at 18–19.

known at this time."[124]

DEK has presented this proposal as one demanded by many of its customers, however, it is clear that only a small portion of its residential customers consistently pay by credit/debit or electronic check. Socializing the cost of these convenience fees by requiring all DEK customers, including low-income customers who can least afford it, to pay for them going forward is patently unfair. While making a payment through these methods may be convenient, the majority of DEK customers likely use other methods to avoid having to pay the convenience fee each month. Furthermore, DEK maintains that the projected expenses of this proposal are known and measurable but that the certain savings from reductions to other expenses are not. If the Company can estimate the cost based on a forecast, then it surely could also estimate projected cost savings from other areas.

Mr. Kollen recommended that the Commission reject the recovery of this expense. The Attorney General recommends the Commission accept this adjustment.

d. Payroll Tax Expense On Incentive Compensation Payroll Expense

DEK removed incentive compensation payroll expense that was related to achieving financial targets for the short-term incentive plan, the long-term incentive plan, and the restricted stock units. However it failed to remove the payroll tax expense on the incentive payroll expense, which Mr. Kollen proposed to remove.[125] In rebuttal testimony, DEK accepted Mr. Kollen's adjustment.[126] The effect of this adjustment is a $0.065M reduction in other taxes expense, and a $0.066M reduction in the revenue requirement. The Attorney General recommends the Commission accept this adjustment.

[124] Kollen Direct at 28–29; DEK Response to AG-DR-2-13.
[125] Kollen Direct at 31.
[126] Lawler Rebuttal at 23, 27.

e. Supplemental Executive Retirement Plan Expense

DEK initially proposed recovery of expenses for Supplemental Executive Retirement Program ("SERP"). Mr. Kollen proposed an adjustment removing these expenses in his testimony.[127] In rebuttal testimony, DEK accepted Mr. Kollen's adjustment to SERP and removed those expenses from the revenue requirement.[128] The effect of this adjustment is a reduction to the revenue requirement in the amount of $0.122M.[129] The Attorney General recommends the Commission accept this adjustment.

f. Amortization of Refunds Received Pursuant to FERC Opinion 494

DEK proposed to amortize $0.260M over five years as a refund to customers for RTEP charges in May and June of 2018.[130] However, DEK previously recorded two refunds it received in 2018, which total $8.0M, as a result of FERC Opinion 494, which approved a settlement agreement entered into by a majority of PJM Interconnection, L.L.C. ("PJM") transmission owners and the state regulatory commissions within PJM. Among those transmission owners was DEK, and the refunds stemmed from overcharges to western PJM transmission owners, including DEK, for Regional Transmission Expansion Plan projects built in the eastern portion of PJM.[131] DEK did not defer either refund as a regulatory liability to amortize as a return to customers in a future rate case, instead taking the refunds as credits to transmission O&M expense to its 2018 income, arguing that the costs for the two separate refund time periods were initially borne entirely by

[127] Kollen Direct at 32–34.
[128] Lawler Rebuttal, at 24–25, 27.
[129] *Id*.
[130] Kollen Direct at 34–35 (quoting LK-17: DEK response to AG-DR-2-32).
[131] *Id*. at 34 (citing LK-16: DEK 2018 FERC Form 1 at 123.11).

shareholders.[132] Therefore, DEK maintains that its customers are not entitled to the refunds, except for the period of May through June 2018.[133]

Mr. Kollen discussed the history of DEK's RTO membership, first in the Midcontinent Independent System Operator ("MISO"), then in PJM after leaving MISO in 2012, and the actual transmission O&M expense incurred by DEK for each year from 2012 to 2018.[134] During those years, the Company recovered more in revenue for transmission expense than it actually incurred.[135] Before Case No. 2017-00321, DEK had not reset its rates since Case No. 2006-00272, but in the interim switched to PJM from MISO in 2012. That switch yielded lower transmission O&M expense from 2012–2018; however, base rates still included the costs based on the higher MISO expenses.[136]

Mr. Kollen recommended that the Commission direct the Company to defer, amortize, and return the entirety of the $8.0M refund it received to its customers, instead of simply the $0.260M amount proposed by the Company. The Commission similarly directed Kentucky Power Company to amortize and return $5.2 M related to RTEP refunds to its customers as a result of FERC Opinion 494 in Case No. 2019-00349.[137] Mr. Kollen also recommended that the Commission use DEK's proposed amortization of five years for the $0.260M, and apply the same amortization period to the refund of the full $8.0M. The effect of this adjustment is a $1.600M reduction in transmission expense and a $1.603M reduction in the revenue requirement. The Attorney General recommends that the Commission accept this adjustment.

[132] *Id*. at 35 (quoting LK-17: DEK response to AG-DR-2-32).
[133] *Id*.
[134] *Id*. at 35–36.
[135] *Id*.
[136] *Id*. at 37.
[137] *Id*.

g. DEBS Cost of Capital

DEK initially included DEBS affiliate charges in the amount of $0.751M in its revenue requirement for a "return", or the cost of capital, on its share of the "rate base" costs DEBS charged to DEK for assets owned by DEBS.[138] Mr. Kollen recommended a reduction to the revenue requirement in the amount of $0.678M to eliminate the Company's "proxy" share of a return on a "proxy" rate base consisting of those DEBS assets, with a corresponding increase of $0.073M in charges for an allocation of DEBS short-term interest expense.[139] Thus, any DEK recovery of DEBS' cost of capital would be limited to interest on short-term intercompany debt.[140]

In rebuttal testimony, DEK stated that it had "inadvertently excluded the entire return on DEBS' assets from its test period expenses."[141] Mr. Setser refers to DEK's response to AG-DR-1-39, in which the Company disclosed that it had failed to include $914,966 of intercompany A&G rent expense in Account 931008, which is the account where the entire return on DEBS assets is recorded.[142] Through rebuttal testimony, Mr. Setser explained that Mr. Kollen's recommended adjustment is moot, since the component of the revenue requirement Mr. Kollen's adjustment eliminates was never properly included in the test year.[143] The Company further clarified that it is "NOT requesting to revise its revenue requirement upwards for the inadvertent omission."[144]

With this clarification and confirmation, the Attorney General recommends that the Commission disregard Mr. Kollen's recommended adjustment since it is rendered moot and unnecessary as a result of the Company's error in failing to include the expense in its filing.

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[138] *Id*. at 38–41; DEK Response to AG-DR-1-50.
[139] *Id*. at 41.
[140] *Id*. at 38–41.
[141] Rebuttal Testimony of Jeffrey R. Setser [Setser Rebuttal], at 1–4 (Ky. Commission January 31, 2020).
[142] *Id*. at 3.
[143] *Id*.; *See also* DEK Responses to AG-Post-Hearing Data Requests, Item 2.
[144] Setser Rebuttal at 4.

h. Amortization of DEBS EDIT As A One-Time Credit

DEK should refund the amount of Excess Accumulated Deferred Income Taxes ("EDIT") to customers that DEBS improperly retained after changes from the Tax Cuts and Jobs Act ("TCJA"). Prior to the TCJA, DEBS recorded federal Accumulated Deferred Income taxes ("ADIT") on its accounting books at the then federal income tax rate of 35%.[145] After the enactment of the TCJA, DEBS recorded ADIT at 21%, and recorded the reduction as EDIT, but unlike DEK, DEBS declined to retain EDIT on its books for a possible future refund to DEK and its affiliates. DEBS instead recorded the EDIT as a reduction to deferred income tax expense, with no offsetting deferral to a liability, resulting in an increase to income in 2017.[146] DEBS had collected the ADIT at the 35% tax rate from DEK in prior years, earning a "'proxy' return on the 'proxy' rate base" explained *supra*.[147] Since DEBS is a service company to DEK and its affiliates, it should have rightly refunded any EDIT to those affiliates, to in turn be refunded to customers, as the Commission ordered in multiple tax case dockets following the TCJA.[148]

In rebuttal, Mr. Setser disagreed with Mr. Kollen's adjustment. Mr. Setser stated that "DEBS does not allocate out income tax expense, current or deferred."[149] However, as Mr. Kollen explained in response to a data request from DEK, "DEBS ADIT was the accumulated income tax effect of temporary differences in prior years, not the result of DEBS net income in those prior years. The DEBS EDIT was simply the result of the reduction in the federal income tax rate applied to those temporary differences."[150] DEBS acquired and depreciated assets for both book and income tax purposes. DEBS' use of bonus depreciation and Modified Accelerated Cost Recovery

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[145] Kollen Direct at 42.
[146] *Id*.
[147] *Id*. at 43.
[148] *Id*.; *See generally* Case Nos: 2018-00034, 2018-00035, 2018-00036, 2018-00039, 2018-00040, 2018-00041, 2018-00042, 2018-00043.
[149] Setser Rebuttal at 5.
[150] AG Response to DEK-DR-1-35 (Ky. Commission January 17, 2020).

System ("MACRS") accelerated depreciation for income tax purposes "created temporary differences and the resulting ADIT for the bonus and accelerated tax depreciation in excess of straight-line depreciation."[151] Then, DEBS charged DEK and its affiliates for the depreciation expense on those assets.[152] Thus, the savings in future income taxes belong to the affiliates that are charged for the cost of those plant assets by DEBS.

Mr. Kollen recommended that the Commission allocate the DEBS EDIT to DEK in the same manner that the DEBS depreciation expense is allocated to DEK, then refund the EDIT amount to DEK customers as a one-time credit or refund.[153] The effect of Mr. Kollen's recommendation is a one-time refund or credit in the amount of $0.214M. The effect on the revenue requirement is the retail jurisdictional effect of the EDIT grossed-up for income taxes.[154] The Attorney General recommends the Commission accept this adjustment.

i. Increases to Depreciation Rates Only Two Years After The Commission Adopted Present Depreciation Rates Are Unnecessary

In the application, the Company proposed new depreciation rates despite having depreciation rates set in its last rate case, Case No. 2017-00321, less than two years ago.[155] The effects of the request to update depreciation rates increase the depreciation expense and the rate increase by $7.431M annually, all else equal.[156] Mr. Kollen noted that this request represents 16.3% of the Company's total initial ask.[157]

[151] Kollen Direct at 43.
[152] *Id*.
[153] *Id*. at 43–44.
[154] *Id*. at 44 ("The total DEBS EDIT at December 31, 2017 was $21.725 million. DEK would have been allocated $0.61 million of this amount if DEBS had not retained the EDIT and recorded it to income in 2017. It is then necessary to gross-up the DEBS EDIT to a revenue equivalent in the same manner that the Company's EDIT was grossed-up to a revenue requirement equivalent for refund purposes.)
[155] *See* Order, Case No. 2017-00321, at 4, 26–28, 33 (Ky. Commission April 13, 2018).
[156] Kollen Direct at 45 (referring to DEK Response to AG-DR-1-33).
[157] *Id*.

In rebuttal, Mr. John Spanos acknowledges that depreciation rates developed as part of a depreciation study such as his are "generally reasonable for a period of three to five years,"[158] but that sometimes more frequent updates of rates are warranted or necessary to appropriately align the actual depreciation to changes in utilization of assets.[159] Mr. Spanos went on to note that the Company has added property to its generating facilities, which "typically result in an increase in depreciation rates even if life and net salvage estimates do not change because new additions have to be recovered over the remaining life span of the facility."[160]

However, as Mr. Kollen stated, there are *no significant known changes* in the depreciation parameters, or assumptions, for plant at the depreciation study date in this case, December 31, 2018, and parameters for plant at the depreciation study in Case No. 2017-00321, December 31, 2016.[161] Conversely, "[t]he proposed changes in certain parameters are changes in assumptions or estimates, including estimates of future costs that have not yet been incurred, e.g., increases in net negative interim and terminal salvage that are recovered pre-emptively."[162] The Company has presented no compelling evidence to justify its request for new depreciation rates so soon after rates were set based on estimates for the same expenses the Company itself requested in the last case. Moreover, the Commission will be able to review depreciation rates in future filings by DEK, which will better document any necessary changes to the Company's assumptions and estimates from Case No. 2017-00321. Further, the depreciation expense on the additional plant is included in the test year. The Attorney General simply recommends that the depreciation rates applied to all plant, including this additional plant, not be increased in this proceeding. The Attorney General

[158] Rebuttal Testimony of John J. Spanos [Spanos Rebuttal], at 11 (Ky. Commission January 31, 2020); Kollen Direct at 46 (quoting Direct Testimony of John J. Spanos [Spanos Direct], Attachment JJS-1, at 50 of 364 (Ky. Commission September 3, 2019).
[159] Spanos Rebuttal at 11–12.
[160] *Id*. at 12.
[161] Emphasis added.
[162] Kollen Direct at 47.

recommends that the Commission reject the Company's request to change its depreciation rates and the associated increases to expenses in this proceeding.

j. Terminal Net Salvage For Steam Production And Other Production Plant Accounts

In completing his depreciation study for the Company, Mr. Spanos added terminal net salvage to the remaining net book value of both the East Bend plant and the Woodsdale CTs, in order to calculate the depreciation expense and the net negative salvage he included in the proposed depreciation rates. In making these calculations, Mr. Spanos relied upon the decommissioning study performed by Burns & McDonnell ("BMD") in 2017, which included estimates of terminal net salvage, and in turn included contingency costs over and above the indirect or overhead costs for decommissioning East Bend and Woodsdale. In addition, Mr. Spanos applied an annual 2.5% escalation factor to increase the BMD estimates for the East Bend plant to 2041 and the Woodsdale CTs to 2032.

The inclusion of contingency costs is inappropriate and arbitrarily increases the decommission costs for both East Bend and Woodsdale above the BMD decommissioning study that was just performed in 2017. The decommissioning for each asset is conservatively scheduled 21 and 12 years from now, respectively, when the cost of decommissioning will certainly change and will be reevaluated based on labor and material costs at that time. Any contingency granted now would unnecessarily inflate the decommissioning cost the Company will rely on. If the Commission considers resetting the depreciation rates instead of denying them outright, it should deny the inclusion of contingency costs, and direct the Company to rely on project bids when the retirement of its assets is requested.

Similarly, the inclusion of an escalation rate "improperly 'frontloads' the present ratemaking recovery of an estimate of future costs in future dollars, all of which are uncertain."[163] By adopting this escalation rate, the Company assumes no increased efficiencies in the decommissioning process, lower material costs, advances in technology, or improvements in productivity that would necessarily offset possible future inflation in project costs.[164] With at least 12 years until the estimated retirement date of Woodsdale, and 21 for East Bend, such advances which would lead to lower costs are almost certain to occur at least on some scale. If the Commission considers resetting the depreciation rates instead of denying them outright, it should deny an escalation rate and instead direct the Company to rely on project bids when the retirement of its assets is requested.

Mr. Kollen recommends that the Commission reject DEK's proposed changes to its depreciation rates, the resulting increase in depreciation expense, and the increase to the revenue requirement, as discussed *supra*. Alternatively, if the Commission deems it necessary to set new depreciation rates, Mr. Kollen recommends that those rates be set according to the BMD decommissioning estimates without contingency costs and without escalation for the terminal net salvage component of the proposed depreciation rates for the East Bend and Woodsdale CTs plant accounts. The effect of Mr. Kollen's alternative recommendation is a $2.111M reduction in the revenue requirement, which consists of a reduction of $2.151M in depreciation expense, the gross up related to the Commission maintenance fees, and the return on rate base effects due to changes in accumulated depreciation and ADIT. The Attorney General agrees that the proposed depreciation rates should be denied, but that should the Commission decide to reset them, it should use Mr. Kollen's alternative recommendation.

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[163] *Id*. at 51–52.
[164] *Id*.

k. Life Span for Woodsdale CTs

The Company maintains that the Woodsdale CTs should be depreciated over a 40-year life, which would put the retirement date for the units in 2032. As discussed already, Mr. Spanos used the 40-year life provided by the Company in his depreciation study and did not independently determine the depreciable lives of the units.[165] However, the Company has provided no evidence that it actually intends to retire the units in 2032. In DEK's most recent integrated resource plan ("IRP"), the Company did not reflect the possible retirement of the Woodsdale CTs in 2032, nor did it address any possible plans to replace that lost capacity.[166] In response to discovery proffered by the Attorney General regarding the remaining lifespan of the Woodsdale CTs, the Company answered that a 40-year life was assigned to the asset but that any remaining lifespan could be extended through capital expenditure if deemed prudent.[167] Moreover, in May of 2019, a $55 million project to add dual fuel capability to Woodsdale through the addition of an ultra-low sulfur diesel system officially went online. Such a large investment for an asset the Company plans to retire in 2032 seems foolhardy and would not have taken place if DEK projected Woodsdale to become uneconomic anytime soon. As Mr. Kollen described, CT units like those in service at Woodsdale remain economic through a lifespan of 50 years or more. Comparable units, including those owned by other DEK utility affiliates, have been in operation for close to or more than 50 years, many without planned retirement dates.[168]

Mr. J. Michael Mosley offered testimony on the overview and operation of the Company's generation assets as the Vice President of Midwest Generation for DEBS.[169] Mr.

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[165] VTE, February 19, 2020, at 11:03:23 — 11:21:14.
[166] Kollen Direct at 53–54 (citing to Case No. 2018-00195; Case, No. 2018-00195, DEK Response to AG-DR-2-1).
[167] *Id*.
[168] *Id*. at 55–56.
[169] Direct Testimony of J. Michael Mosley [Mosley Direct], at 1 (Ky. Commission September 3, 2019).

Mosley is also a licensed Professional Engineer with significant experience onsite at power plants managing operations.[170] In his direct testimony, Mr. Mosley explained that Woodsdale was designed as a peaking unit resource, which "run infrequently to meet peak demand," have a much lower capacity factor than baseload units, and are "generally dispatched in response to market price signals." On cross-examination, Mr. Mosley indicated that the Woodsdale units are used on average one to two times per week.[171] He also confirmed that the Woodsdale units, like all combustion turbines, are fully capable of black starts and quickly ramping up or down to meet peaking demand, and that it is common to do so.[172] He stated that one of the possible issues with operating the Woodsdale units beyond the assumed 2032 retirement date could be the relative unavailability of parts to perform repairs, but he confirmed that to date DEK has not had issues with obtaining parts for the Woodsdale units.[173] In his direct testimony, he also described the Company's recent completion of a new backup ultra-low sulfur diesel fuel system for Woodsdale, which was commissioned in May 2019.[174] This low rate of intermittent usage, the flexibility of the combustion turbines, and recent investment all point to Woodsdale having a lifespan longer than the 40 years relied upon by the Company.

Mr. Kollen recommended that the Commission reject the Company's proposed changes to its depreciation rates and the increased depreciation expense and revenue requirement. Alternatively, should the Commission decide to reset the depreciation rates, Mr. Kollen recommended that the Commission extend the life of the Woodsdale CTs by 10 years, for a total lifespan of 50 years, setting a probable retirement date of 2042. The effect of Mr. Kollen's

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[170] *Id.*
[171] VTE, February 19, 2020, at 14:07:42 —14:12:50.
[172] *Id.*
[173] *Id.*
[174] Mosley Direct at 12–14.

recommendation is a $5.305M reduction in the revenue requirement, consisting of a reduction of $5.407M in depreciation expense, the gross up related to Commission maintenance fees, and the return on rate base effects due to changes in accumulated depreciation and ADIT. The Attorney General agrees that the proposed depreciation rates should be denied, but that should the Commission decide to reset them, it should use Mr. Kollen's alternative recommendation.

3. <u>Cost of Capital Issues</u>

a. Cost of New Long-Term Debt Issuance

In the test year, the Company included a forecast of $50M in new intermediate to long-term debt it plans to issue at 4.0% on September 15, 2020,[175] with the cost weighted for the portion of the test year the issuance would be outstanding. DEK "does not yet know whether it will issue five, ten, or thirty year debt or some combination of those tenors. Consequently, it used the forward yield curves as of June 30, 2019 to forecast the cost of debt for each of those tenors and weighted the five-year tenor at 10%, ten-year tenor at 35%, and thirty-year tenor at 55%."[176] The Company then used forecasted Treasury yields for each tenor and added a credit spread to each to arrive at its projected cost for this debt issuance of 4.0%.[177]

Mr. Kollen recommended that the Commission simply update the Treasury yields used in the calculation of the interest rates of each tenor, to properly reflect the most recent yields.[178] By using current Treasury yields, then adding the same credit spreads and tenor weighting used by the Company, Mr. Kollen calculated that DEK's cost of debt issuance is 3.68% instead of 4.0%.

Mr. Jacobi disagreed with Mr. Kollen's proposed adjustment to the Company's long-term debt rate, asserting that he singled out this metric for an adjustment in isolation without properly

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[175] Application, Schedule J-3, at page 2 of 2.
[176] Kollen Direct at 57.
[177] *Id*.
[178] *Id*. at 58

considering other components of the revenue requirement.[179] Mr. Jacobi also asserted that a fully forecasted test year is DEK's right under Kentucky law, and that the Company cannot make changes to the test year.[180] Under cross-examination, Mr. Jacobi agreed that the Commission can make changes to the test year and that it is appropriate for the Commission to test the reasonableness of rate base expense against historical data.[181] Mr. Jacobi also argued that Mr. Kollen failed to consider the forward curve of the long-term debt rate from December 6, 2019 to 2020.[182] However, again, current rates are a better proxy than forecasted rates, which are subject to wide variability and unknown factors. As discussed *supra*, the Commission has maintained that current interest rates are preferred to forecasted rates, especially in a low-interest rate environment. DEK has not presented any evidence to convince the Commission to change its stance on this issue. Moreover, since Mr. Kollen's direct testimony was filed, 30-Year Treasury yields have *dramatically* declined, thus providing additional evidence that the Company's forecast interest rate for the new debt issue is excessive. Even Mr. Kollen's proposed adjustment results in an excessive rate for this new debt issue.

The Commission should accept Mr. Kollen's recommendation to update the Treasury yields in the calculation of the current interest rate for each tenor with the most recent yields. The effect of this recommendation is a reduction of at least $0.056M in the base revenue requirement using the interest rates at the time when the Attorney General filed Mr. Kollen's Direct Testimony. Mr. Kollen noted that there would also be an effect on the ESM revenue requirement, but he did not quantify that effect. The Attorney General recommends the Commission accept this adjustment.

[179] Jacobi Rebuttal at 5.
[180] *Id*. at 5–6.
[181] VTE, February 19, 2020, at 15:38:20 — 15:49:52.
[182] Jacobi Rebuttal at 5–6.

4. <u>Proposed New Projects and Programs</u>

a. Battery Storage Project

In the application, DEK proposed a three year pilot for a new battery storage project which would operate in the Ancillary Services Market ("ASM") of PJM, primarily providing benefits to the PJM system through frequency regulation.[183] The overall cost of the project is $8.2M, and with an in-service date of December 31, 2020, it would result in $2.4M of net plant included in rate base based on a 13-month average.[184] The impact to the requested revenue requirement in this case is $350,000.[185] The project was originally slated to produce revenues of $800,000 per year, based on a $20 per MW hour price from the PJM Regulation D market,[186] while the annual operating cost was $163,000, which was not included in the test year.[187] If net revenues materialize, they will be distributed through the profit sharing mechanism ("PSM") rider, on a 90/10% split between customers and the Company, respectively.[188] The project was originally to be implemented near a major hospital in DEK's service territory "in order to increase reliability on that circuit,"[189] where some of the insights to be gained related to the integration of a battery backup system for the hospital, providing about 3 hours of backup service for the facilities during an outage.[190] The Company did not seek a certificate of public convenience and need ("CPCN"), asserting that the project cost does not amount to a sufficient outlay of capital "to materially affect the financial condition of Duke Energy Kentucky" and that due to the limited size and scope of the project, it would represent an ordinary extension of the Company's distribution system in the ordinary course

[183] Direct Testimony of Zachary Kuznar, PhD [Kuznar Direct], at 2–4.
[184] Lawler Direct at 15–16; Kuznar Direct at 10.
[185] Lawler Direct at 15–16; Kuznar Direct at 10.
[186] Kuznar Direct at 7–8.
[187] *Id*. at 11.
[188] *Id*. at 7–8.
[189] *Id*. at 5, 8–9.
[190] *Id*. at 3, 8–9.

of business.[191] It does request that if the Commission determines a CPCN is necessary, to grant it with the application in the instant case.[192]

In rebuttal testimony, the Company explained that due to technical complications with implementing the battery storage with the original partner, the project had been relocated to a different circuit that serves an existing DEK solar array, the Crittenden Solar Farm.[193] As a result of the move and downsizing the battery size from 5MW to 3.4MW, the projected annual revenues fell from the original estimate of $800,000 to $470,000.[194] The primary purpose of the project remains frequency regulation, but now also includes solar smoothing, solar shifting, and voltage support.[195] Despite the downsizing, the annual projected O&M costs remain $163,000.[196]

The Company justifies the overall cost of the project by stating that it will glean crucial information and that "lessons learned" from implementing battery storage on its system now will "enable the successful implementation of future projects."[197] Additionally, this would be the first battery storage project on Duke Electric's entire system to participate in PJM, which would provide further insight to the Company and its affiliates.[198] As Mr. Kollen stated in testimony, even prior to the downsizing and reduction to estimated revenue of the pilot, "the project is a net economic loser on an annual basis" and other Duke Energy affiliates, especially unregulated ones, could implement an identical pilot within PJM and provide DEK with the appropriate insights gained.[199] As Vice-Chair Cicero noted at the hearing, the project's overall cost remained $8.2M despite the

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[191] *Id*. at 3, 11.
[192] *Id*. at 11.
[193] Rebuttal Testimony of Zachary Kuznar, PhD [Kuznar Rebuttal], at 2 (Ky. Commission January 31, 2020).
[194] *Id*. at 5.
[195] *Id*. at 2–3.
[196] *Id*. at 6.
[197] Kuznar Direct at 5.
[198] VTE, February 19, 2020, at 18:25:10 — 18:39:15.
[199] Kollen Direct at 62.

downsizing, and such costs would take 27 years to recover without including carrying costs.[200] Finally, in response to a question from Commissioner Mathews as to what PJM capacity value would make the Company's cost-benefit analysis positive, Dr. Kuznar answered that he did not know.[201]

The Attorney General disagrees with the Company's proposal that requires DEK ratepayers to both fund the entirety of this project and bear the risk if the estimated revenues fail to materialize, or if the other benefits are not fully realized. Additionally, with the uncertainty remaining over FERC Order 841 regarding storage and final rules still to come from PJM, DEK ratepayers should not be required to fund a pilot project with such ephemeral benefits such as "valuable insight on how to incorporate energy storage into its existing operation."[202] If such benefits are indeed valuable to the Company, then shareholders should fund this "small pilot"[203] project and report back to the Commission with a cost benefit analysis showing clear returns for ratepayers before asking them to fund further battery storage.

Mr. Kollen recommended that the Commission reject this project since it is discretionary, an unnecessary cost, and unnecessary for the provision of electric service. Accordingly, the Attorney General recommends that the Commission deny the project as proposed. The effect of this recommendation is a $0.350M reduction to the revenue requirement.

[200] VTE, February 19, 2020, at 18:25:10 — 18:39:15.
[201] VTE, February 19, 2020, at 19:01:40 — 19:01:55.
[202] Kuznar Direct at 5.
[203] Kuznar Rebuttal at 12.

b. Electric Vehicle Charging Pilot Program

DEK also proposed an Electric Vehicle ("EV") Pilot Program, consisting of five separate program components.[204] The total cost of the EV Pilot Program is $2.834M.[205] The EV Fast Charge component of the pilot would be comprised of the construction of five fast charge stations, with two charging points each.[206] DEK has stated that the driving force behind this component is that private industry is not deploying charging infrastructure at the scale necessary to support advanced EV market growth.[207]

As it stood when the application was filed, there were only 320 EVs registered in the Company's service territory and 2,200 registered in all of Kentucky.[208] With this reality, DEK projects "minimal revenues" from the EV Fast Charge program to begin with, but provides assurances that revenue will increase along with the EV adoption rates it relied upon in formulating this program.[209]

In rebuttal, Mr. Reynolds listed the existing EV charging stations in DEK's service territory.[210] Of those, there are fifteen Level 2 charging stations and one direct current fast charging ("DCFC") that are 24-hour publically accessible and which utilize non-proprietary technology.[211] When asked on cross-examination whether DEK analyzed the utilization rates of those current EV

[204] Direct Testimony of Lang W. Reynolds [Reynolds Direct], at 6–7 (Ky. Commission September 3, 2019) (Those components include: 1. EV Fast Charge 2. Electric Transit Bus Charging 3. Non-Road Electrification Incentive 4. Residential EV Charging Incentive 5. Commercial EV Charging Incentive).
[205] *Id*. at 9.
[206] *Id*. at 10.
[207] Rebuttal Testimony of Lang W. Reynolds [Reynolds Rebuttal] at 12 (Ky. Commission January 31, 2020); VTE, February 19, 2020, at 8:30:40 — 8:39:32; 9:11:15 — 9:13:48.
[208] Reynolds Direct at 5.
[209] *Id*.; DEK Response to Staff DR-2-90.
[210] Reynolds Rebuttal, LWR-Rebuttal-1.
[211] *Id*.; VTE, February 19, 2020, at 8:30:40 — 8:39:32; 9:11:15 — 9:13:48.

charging stations, Mr. Reynolds stated that DEK had not, in part because some owners of those stations were reluctant to share such information with DEK.[212]

In response to questions from NKU counsel regarding the dynamic between DEK's monopoly power competing against private firms, and whether that was proper, Mr. Reynolds answered that, in his personal opinion, it was.[213]When asked by the Attorney General why Duke Energy did not simply introduce an EV Pilot through one of its affiliates in an unregulated jurisdiction, Mr. Reynolds said that by and large, electric utilities "see [the benefit] as being within the regulated utility model."[214] With this, it seems clear that Duke Energy is preferring to use the monopoly power of DEK in its dedicated, regulated territory, where it is guaranteed an opportunity to earn a return from captive ratepayers to establish a position within the nascent EV charging market.

Moreover, while DEK now characterizes its capacity position as "a little long", it will potentially have to continue purchasing capacity bilaterally to be able to meet its capacity obligations. Due to its status as a Fixed Resource Requirement ("FRR") entity, DEK is not able to procure capacity from the PJM capacity construct, the Base Residual Auction ("BRA"). DEK's ability to procure additional capacity on the bilateral market is further limited to its PJM zone, as required for all FRR entities.[215] If the Company's capacity position becomes short and the Company is forced to substantially increase its capacity procurement, those costs flow back to DEK customers. In this scenario, DEK customers could potentially pay for the EV pilot project on the front end, which would increase system load, and then pay for additional capacity purchases

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[212] VTE, February 19, 2020, at 8:30:40 — 8:39:32; 9:11:15 — 9:13:48.
[213] VTE, February 19, 2020, at 8:51:35 — 8:54:40.
[214] VTE, February 20, 2020, at 8:30:40 — 8:39:32; 9:11:15 — 9:13:48.
[215] Direct Testimony of John A. Verderame [Verderame Direct], at 22–25 (Ky. Commission September 3, 2019); *See also* VTE, February 19, 2020, at 19:14:03 — 19:22:11.

down the line anyway with this project and its cost potentially contributing to those capacity concerns.

DEK's EV Pilot puts unnecessary risk on ratepayers and asks them to pay for a project that could easily be addressed by private industry if and when the market dictates such investment is prudent. While EVs may indeed be the way of the future, DEK has not provided sufficient evidence to convince the Commission to require ratepayer investment for such a pilot project.

Mr. Kollen recommended that the Commission reject this project since it is discretionary, unnecessary, and not economic. The effect of this adjustment is a reduction to the revenue requirement of $0.149M. The Attorney General recommends the Commission accept this adjustment.

C. *Distribution System Spending*

In its application DEK listed return on its increased investment as one of the primary drivers for filing this rate case.[216] In direct testimony, Ms. Ash Norton referred to Schedule B-2.1 of the application, which shows snapshots of the increased net plant in service for DEK since the last rate case: $485M as the 13-month average used for the fully forecasted test year ending March 31, 2019 in Case No. 2017-00321; $491M as the actual plant in service as of March 31, 2019; and $581.6M as the 13-month average used for the fully forecasted test year ending March 31, 2021 in the instant case.[217]

Under cross-examination, Ms. Norton confirmed the amounts referred to in DEK's response to AG-DR-2-76, that for the four year period of 2017–2020 the Company will have spent $239.5M in upgrading its distribution system, with an average of $59.75M per year; that for the four year period of 2013–2016 the Company spent $82.3M in total distribution system upgrades;

[216] Direct Testimony of William Don Wathen Jr [Wathen Direct] at 4–5 (Ky. Commission September 3, 2019).
[217] DEK Response to AG-DR-2-76.

and that the percentage increase between these two periods is 190.47%.[218] Ms. Norton stated that the primary driver of this spending was to address localized load growth on certain circuits, or a small number of certain customers who required upgraded infrastructure.[219]

Ms. Norton also confirmed that among the investor-owned electric utilities in Kentucky, DEK has the best reliability scores for SAIFI, SAIDI, and CAIDI.[220] Despite its excellent scores for reliable service, DEK has still considered its increased spending on its distribution system necessary, as demonstrated by the record in this case. Additionally, in her direct testimony, Ms. Norton goes on to describe the self-optimizing grid that will react in real-time to issues, but will take more than a decade to complete.[221] Neither during discovery nor during cross-examination, could Ms. Norton offer any specificity as to the costs of building and implementing this self-optimizing grid.[222]

The Attorney General is concerned that DEK will continue to invest heavily in its distribution system and continue to ask its ratepayers to pay either for substantial system upgrades primarily for the benefit of a handful of large customers, or for miniscule increases in system-wide reliability that they may not even notice. The Commission should scrutinize any such continued investment for appropriate cost-benefit returns.

D. *Vegetation Management*

In DEK's previous rate case, DEK initially proposed recovery of a vegetation management expense in the amount of $4.480M, which was reduced by the Commission to $4.040M to align

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[218] VTE, February 20, 2020, at 9:20:40 — 9:31:25.
[219] *Id*.; Direct Testimony of Ash M. Norton [Norton Direct], at 5–6 (Ky. Commission September 3, 2019).
[220] AG Hearing Exhibit 2 (SAIFI is the System Average Interruption Frequency Index; SAIDI is the System Average Interruption Duration Index; CAIDI is the Customer Average Interruption Duration Index); VTE, February 20, 2020, at 9:20:40 — 9:31:25.
[221] Norton Direct at 13–14.
[222] VTE, February 20, 2020, at 9:20:40 — 9:31:25.

the expense with DEK's prior four year average for vegetation management.[223] In making this adjustment, the Commission expressed concern at the magnitude of the annual increases to vegetation management expense, requiring DEK/DEBS to bid its next Master Agreement for Vegetation Management Service contract for both the Midwest market, including Kentucky, Indiana, and Ohio, and for a smaller geographic area to be limited solely to the DEK service territory.[224] Further, after reviewing the confidential cost-benefit study submitted by DEK in that case regarding DEK providing vegetation management services itself instead of bidding them out, along with the other information of record, the Commission found that DEK should be required to "study this issue further in order to find ways of making its vegetation management more cost-effective."[225]

In the instant case, DEK proposes $5.5M in test year O&M expenses for routine vegetation maintenance.[226] For 2019, DEK spent approximately $6M, but projects less than this amount for each of 2020 and 2021, closer to $5.5M as requested in the test year.[227] However, the Attorney General remains concerned that vegetation management costs will continue to rise beyond what DEK projects, especially since Mr. Christie testified that the regional issues of contractor shortages and rising rates for vendors in this type of work persist.[228] Due to these ongoing trends, Mr. Christie also stated that contract vendors have not been able to successfully maintain the majority of their laborers, despite efforts to mitigate the losses, and continue to see a turnover rate of about 50%.[229] Mr. Christie explained that the current vendor's contract is up this year, and DEK will decide

[223] Final Order, Case No. 2017-00321, at 16 (Ky. Commission April 13, 2018).
[224] *Id*. at 16–19.
[225] *Id*. at 18.
[226] Direct Testimony of Thomas (TK) Christie [Christie Direct], at 14 (Ky. Commission September 3, 2019).
[227] Christie Direct at 14; DEK Response to AG-Post-Hearing Data Requests, Item 1.
[228] VTE, February 20, 2020, at 10:19:10 — 10:27:35.
[229] *Id*.

whether to exercise its option for a two-year extension on the current contract, or go to market.[230] Finally, Mr. Christie stated that DEK had not seriously considered moving vegetation management services back in-house since it ran a cost-benefit analysis on this option in the last rate case, and that to his knowledge only one electric utility, BC Hydro in Canada, performs those services itself.[231] DEK's costs rose from $4.35M in 2018 to approximately $6M in 2019, an almost 38% increase.[232] Vice-Chair Cicero pointed out that DEK's vegetation management costs have increased by 330% since 2014.[233] If these costs do not level out as DEK expects, ratepayers will continue to shoulder the escalation.

The Attorney General recommends that the Commission require DEK to continue studying this issue and provide updates on its efforts to address the cost-effectiveness of its vegetation management program. If the regional or national trends of contractor labor shortage and increasingly competitive pay continue, the Commission should require DEK to perform another cost-benefit analysis on whether moving these services in-house is feasible, and if not, how DEK will otherwise address this situation.

E. *Customer Charge*

Finally, DEK has requested to increase its customer charge from $11.00 to $14.00. This request is just two years removed from the Commission having granted DEK a $6.50 increase to its customer charge, raising it from $4.50 to $11.00 in Case No. 2017-00321. To grant DEK's current customer charge increase in full would mean *tripling* the upfront, unavoidable cost to a residential ratepayer within the span of three years. This increase to the fixed customer charge would impact customers with low usage disproportionately.

[230] VTE, February 20, 2020, at 10:19:10 — 10:27:35.
[231] *Id*.
[232] Christie Direct at 14.
[233] VTE, February 20, 2020, at 10:27:48 — 10:28:03.

In rebuttal, Mr. Kern pointed to multiple supposed instances of customers favoring a fixed price over a volumetric price, e.g. cable television plans, cellular telephone plans, and automobile rental.[234] However, during cross-examination he admitted that those examples come from largely unregulated industries where customers have a choice of vendors, and that within each industry cited there were *tiers* of fixed price plans, which implies a volumetric measurement.[235] Customers value autonomy, and having some control over the amount of their electric bill affords them that. Increasing the customer charge by 27% further erodes the ability of DEK customers to control the amount of their electric bill through lower usage and consequently lower volumetric charges.

Mr. Kern went on to demonstrate that DEK's current customer charge is still among the lowest of electric utilities in Kentucky, and the proposed $14.00 would place DEK closer to the median.[236] Mr. Kern confirmed during the hearing that such an argument is not a good reason in and of itself to increase the customer charge, but that in theory the correct amount for a customer charge flows directly from the cost of service study.[237] Customers are already bearing an approximate 30% increase in the meter cost allocation described by Mr. Ziolkowski and confirmed at the hearing.[238]

On cross-examination from the Company, Mr. Watkins was asked to compare DEK's customer charge to the other Kentucky investor-owned electric utilities: Louisville Gas & Electric, Kentucky Utilities, and Kentucky Power Company.[239] However, again, the Commission should not place much stock in a simple comparison with other utilities, as the customer charge should

[234] Rebuttal Testimony of Jeff L. Kern [Kern Rebuttal], at 3–5 (Ky. Commission January 31, 2020).
[235] VTE, February 20, 2020, at 13:26:30 — 13:30:57.
[236] Kern Rebuttal at 5–6.
[237] VTE, February 20, 2020, at 13:26:30 — 13:30:57.
[238] Direct Testimony of James E. Ziolkowski [Ziolkowski Direct], at 20 (Ky. Commission September 3, 2020); AG Exhibit 3, Work Paper FR-16(7)(v), Case Nos. 2019-00271 and 2017-00321; VTE, February 20, 2020, at 11:40:30 — 11:44:30.
[239] VTE, February 20, 2020, at 13:26:30 — 13:30:57.

only cover the fixed costs to serve, which is unique to each utility due to multiple factors and is borne out through a cost of service study. Mr. Watkins was also asked about Owen Electric Cooperative's customer charge, since it borders DEK's service territory.[240] As Mr. Watkins explained on redirect, the fundamental difference between a rural electric cooperative ("RECC") and an investor-owned electric utility is that RECCs are non-profit and member owned.[241] Additionally, due to factors such as expansive rural terrain, declining or flat load growth, economic hardship, and greater susceptibility to variations in weather swings, the Commission recognizes the value for a higher customer charge specifically for RECCs.[242] The Commission has stated "for an electric cooperative that is strictly a distribution utility, there is merit in providing a means to guard against revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional economics and changes in weather patterns."[243] Any comparison between setting a customer charge for a distribution-only cooperative utility and a vertically-integrated investor-owned utility is flawed from the outset and should not be given any weight. Accordingly, the Commission should not consider Owen Electric's customer charge in determining DEK's appropriate fixed charge.

Mr. Watkins recommended that the Commission keep DEK's customer charge at its current level, and the Attorney General agrees. The Attorney General recommends the Commission reject DEK's proposal and hold the customer charge steady at $11.00.

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[240] VTE, February 20, 2020, at 13:26:30 — 13:30:57.
[241] *Id*.
[242] Final Order, Case No. 2018-00272, *Application of Grayson Rural Electric Cooperative Corporation for an Adjustment of Rates*, at 31 (Ky. Commission March 28, 2019), quoting Final Order, Case No. 2017-00374, *Application of Big Sandy Rural Electric Cooperative Corporation for a General Adjustment of Existing Rates*, at 11–12 (Ky. Commission April 26, 2018).
[243] *Id*.

III. CONCLUSION

WHEREFORE, the Attorney General respectfully requests that the proposed rates be denied and the Commission limit the amount of any base rate increase to the level recommended herein. Further, the Attorney General requests that the Commission deny the Company's request to increase the customer charge, instead leaving it at its current rate.