COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF DUKE ENERGY	)	
KENTUCKY, INC. FOR AN ORDER	)	
APPROVING THE ESTABLISHMENT OF	)	**CASE NO. 2019-00352**
A REGULATORY ASSET OR	)	
LIABILITY ASSOCIATED WITH	)	
PENSION SETTLEMENT ACCOUNTING	)	

APPLICATION

Comes now Duke Energy Kentucky, Inc. (Duke Energy Kentucky or the Company), by counsel, pursuant to KRS 278.030(1), KRS 278.040(2), KRS 278.220 and other applicable law, and hereby requests that the Kentucky Public Service Commission (Commission) approve the establishment of a regulatory asset and liabilities for the income statement impacts including gains, losses, expenses arising from Pension Settlement Accounting. In support of this Application, the Company states as follows:

I. Applicant Information and General Filing Requirements

1. Duke Energy Kentucky is an investor-owned utility engaged in the business of furnishing natural gas and electric services to various municipalities and unincorporated areas in Boone, Bracken, Campbell, Gallatin, Grant, Kenton, and Pendleton Counties in the Commonwealth of Kentucky.

2. Pursuant to 807 KAR 5:001, Section 14(1), Duke Energy Kentucky's business address is 139 East Fourth Street, Cincinnati, Ohio 45202. Duke Energy Kentucky's local office in Kentucky is 1262 Cox Road, Erlanger, Kentucky 41018 and its electronic mail address is KYfilings@duke-energy.com.

3. Pursuant to 807 KAR 5:001, Section 14(2), Duke Energy Kentucky states that it was originally incorporated in the Commonwealth of Kentucky on March 20, 1901, and attests that it is currently in good standing in said Commonwealth.

II. Background on Pension Accounting

4. Pension Settlement Accounting, is prescribed by the United States Generally Accepted Accounting Principles (U.S. GAAP) under Accounting Standard Codification 715-30 and is an irrevocable transaction that relieves an employer of primary responsibility for benefit obligations under a benefit plan and eliminates significant risks related to the obligation and assets used to affect the settlement. Pension Settlement Accounting triggers recognition in earnings of any gains or losses from settlements equal to the percentage of the settled obligations when the cost of all settlements during a year is greater than the sum of the service cost and interest cost component of net period pension cost for the pension plan for the year.

5. The net periodic pension cost is the amount recognized in an employer's financial statements as the cost of a pension plan for a period. The term net periodic pension cost is used instead of net pension expense because the service cost component recognized in a period may be capitalized as part of an asset such as inventory. Components of net periodic pension cost under Accounting Standards Codification (ASC) 715 are:

- Service cost. Service cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period.
- Interest cost. Interest cost is the increase in projected benefit obligation due to passage of time.

- Expected return on plan assets. The expected return on plan assets is calculated by applying the expected rate of return on plan assets to the beginning of year amount of plan assets.
- Gain or loss amortization. Gains and losses are changes in the amount of projected benefit obligations or plan assets due to actual experience that is different than assumed experience, as well as changes in assumptions, such as the discount rate applied to future cash flows expected to satisfy the pension obligation. Amortization expense is included in net periodic pension cost when beginning of year unrecognized gain or loss exceeds a "corridor" of ten percent of the greater of the projected benefit obligation or the market-related value of plan assets. Amounts in excess of the corridor are amortized over the average remaining future service of active plan participants, or average remaining life expectance for plans, where almost all (more than 90%) of the plan participants are inactive.
- Prior service cost or credit. Prior service cost or credit represents the cost of retroactive benefits granted in a plan amendment that increase of decrease the projected benefit obligation. Amounts are amortized over the average remaining future service of active plan participants, or average remaining life expectance for plans, where almost all (more than 90%) of the plan participants are inactive.

6. Duke Energy Kentucky maintains a regulatory asset or regulatory liability on its books that includes pension actuarial losses or gains. These losses or gains are created when the pension plans' actual experience differs from assumed experience or due to

changes in assumptions. Current accounting rules specify that those regulatory assets or regulatory liabilities are to be amortized over the average remaining service life if the pension plan is active, or the life expectancy of the plan participants if the pension plan is inactive. This amortization expense is one component of pension expense and is recorded in FERC Account 926, Employee Pensions and Benefits. The amortization expense is included in cost of service.

III. Pension Settlement Accounting

7. If Pension Settlement Accounting is triggered for regulated entities, the losses on the settled portion of the net periodic pension obligation must be reflected as an expense immediately, unless it is probable the costs (the amortization of which are currently a portion of pension cost being recovered through rates) will be recovered through rates. Examples of settlement transactions include making lump-sum cash payments to plan participants in exchange for their rights to receive their pension benefit, assumption of the benefit obligation by a buyer as part of a business combination, and the purchase of a nonparticipating annuity contracts to cover participants vested benefits.

IV. Applicability of Pension Settlement Accounting

8. In 2018, the Duke Energy Corp., and its subsidiaries, including Duke Energy Kentucky undertook efforts to reduce workforce by a significant number of employees for both service company and gas and electric operations.[1] Many of those employees have chosen to take lump sum payments from the pension plan in 2019. As a result, it was determined probable in the second quarter of 2019, that the lump sum payments would exceed the threshold amount for Duke Energy Corp. under the plan.

[1] Approximately 1,900 in total workforce reduction was achieved across Duke Energy Corp.

Therefore, in the second quarter of 2019, Duke Energy Kentucky triggered Pension Settlement Accounting for the first time and booked settlement accounting entries for the second quarter. Additional settlement accounting entries will be booked for the remainder of 2019. Settlement charges are estimated to be approximately:

	Settlement Charges 2019[a]
Duke Energy Kentucky electric	$ 305,366
Duke Energy Kentucky gas	$ 101,048

[a] Estimated charges based on forecast.

9. Duke Energy Kentucky also anticipates recognizing future settlement charges in subsequent years because the Companies have closed their pension plans to new employees which means the threshold amounts for triggering settlement accounting will continue to decrease therefore increasing the frequency of triggering Pension Settlement Accounting in the future. Charges in future settlement events could well exceed these levels.

10. Duke Energy Kentucky requests approval to continue to record settlement charges that are incremental to base rates, in regulatory asset and regulatory liability accounts and continue amortizing those amounts in the same way they would be amortized absent this Pension Settlement Accounting trigger. Absent this approval, the Company will be required to recognize expense or income impacts to its financial statements that are lumpy and irrational and are not aligned with current rates. Additionally, absent this approval, the Company would be treating Pension Settlement Accounting differently than all other aspects of its pension plan accounting.

11. The Company proposes that the settled portion of the losses or gains be moved to a separate regulatory asset or liability account and continue to be amortized over the average remaining service period of the pension plan participants. The Company's

request will simply enable it to record all Pension Settlement Accounting impacts in regulatory asset or regulatory liability accounts and to amortize those assets or liabilities in the same manner they would have been amortized had the Pension Settlement Accounting not been triggered. The Commission would adjust those amortization amounts or periods in future rate cases if needed. This is the treatment the Company is requesting Commission authority for, both for the Pension Settlement Accounting triggered in 2019, as well as for any future Pension Settlement Accounting triggered.

12. The Company already has deferral authority for all other aspects of its pension plan accounting. This request is to keep the treatment of Pension Settlement Accounting consistent with all other aspects of its pension plan accounting.

V. Request to Establish a Regulatory Asset and Liability

13. Pursuant to KRS 278.220, the system of accounts "for electric companies shall conform as nearly as practicable to the system adopted or approved by the Federal Energy Regulatory Commission" (FERC).

14. A regulatory asset or liability may be created when a utility is authorized to capitalize a loss or defer a gain that, under traditional accounting rules, would be recorded as a current gain or loss. The reclassification of a gain or loss to a regulatory asset or liability allows the utility the opportunity to request recovery or refund to customers in future rates the deferred gain or loss. The authority to establish regulatory assets and liabilities arises out of the Commission's plenary authority to regulate utilities under KRS 278.040 and to "establish a system of accounts to be kept by utilities subject to its jurisdiction... and may prescribe the manner in which such accounts shall be kept."[2]

[2] KRS 278.220.

15. Duke Energy Kentucky must obtain Commission approval for accounting adjustments before establishing a new regulatory asset or liability. Specifically, the Commission stated in Case No. 2001-00092, "[t]herefore, the Commission finds that in the future, ULH&P shall formally apply for Commission approval before accruing a cost as a deferred asset, regardless of the rate-making treatment that the Commission has afforded a similar cost in previous rate case proceedings."[3]

16. The Commission has exercised its discretion to approve regulatory assets where a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[4] In exercising discretion to allow the creation of a regulatory asset, the Commission's overarching consideration has been the

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[3] *In the Matter of Adjustment of Gas Rates of The Union Light, Heat and Power Company,* Final Order, Case No. 2001-00092 (Ky. P.S.C., Jan. 31, 2002).

[4] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages,* Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008); *In the Matter of the Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00456 (Ky. P.S.C., Dec. 22, 2008); *In the Matter of the Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00457 (Ky. P.S.C., Dec. 22, 2008); *In the Matter of the Joint Application of Duke Energy Kentucky, Inc., Kentucky Power Company, Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to Certain Payments Made to the Carbon Management Research Group and the Kentucky Consortium for Carbon Storage,* Final Order, Case No. 2008-00308 (Ky. P.S.C., Oct. 30, 2008); *In the Matter of the Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations,* Final Order, Case No. 2001-00169 (Ky. P.S.C., Dec. 3, 2001).

context in which the regulatory asset is sought to be established and not necessarily the specific nature of the costs incurred.[5]

17. Duke Energy Kentucky asserts that its request to establish a regulatory asset for Pension Settlement Accounting constitutes both "an expense resulting from a statutory or administrative directive" and "an extraordinary or nonrecurring expense that over time will result in a savings that fully offsets the cost. Here, Pension Settlement Accounting is triggered in accordance with GAAP. The settlement charge resulting from the triggering of Pension Settlement Accounting was attributable to the Company's cost savings initiatives in reducing employee headcount, namely lump sum payments from the existing pension plans, which over time, will offset the costs incurred. Pension Settlement Accounting does not change the cost of the pension plan over the life of the plan, but accelerates the recognition of the gains/losses. The cost savings are derived from reducing headcount, but the pension costs remains unchanged. Had Pension Settlement Accounting not been triggered, the gains/losses would have been recorded to a FERC account 182.3 regulatory asset and amortized over the estimated remaining service life of the employees in the pension plan.

18. If approved, Duke Energy Kentucky will hold its deferred costs in Account No. 182.3, Other Regulatory Assets, until such time as the Commission considers the method of recovery in a future rate proceeding.

19. If the Commission approves Duke Energy Kentucky's requested regulatory asset treatment, Duke Energy Kentucky expects to make the following journal entries based

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[5] *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008).

on estimates available as of September 10, 2019. Note that amounts were originally recorded in a 182.3 account but when Pension Settlement Accounting was triggered, it caused the Company to record the resulting settlement charge to a 926 account. Because the Company believes the deferral authority is probable, the Company has recorded the settlement charge temporarily to a 186 account. Once the Commission grants the deferral authority requested in this application, the Company will record the following entries. Amounts may change as new information regarding Pension Settlement Accounting costs estimates becomes available:

Duke Energy Kentucky - Electric

Dr. 182.3 Other regulatory assets (Settlements)	$305,000
Cr. 186 Other deferred debits	$305,000

Duke Energy Kentucky – Gas

Dr. 182.3 Other regulatory assets (Settlements)	$101,000
Cr. 186 Other deferred debits	$101,000

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky respectfully requests that the Commission enter an Order:

1. Approving the establishment of a regulatory asset for the income statement impacts- including gains, and losses, associated with Pension Settlement Accounting arising from employee reductions;

2. Permitting the deferral of appropriate carrying costs as part of the regulatory assets described herein; and

3. Granting Duke Energy Kentucky all other additional relief to which it may appear entitled.

Respectfully submitted,

Rocco O. D'Ascenzo (92796)
Deputy General Counsel
Duke Energy Business Services LLC
139 East Fourth Street/1303-Main
Cincinnati, OH 45202
(513) 287-4320
Rocco.D'Ascenzo@duke-energy.com

Counsel for Duke Energy Kentucky, Inc.

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing Application of Duke Energy Kentucky, Inc. has been served via electronic mail to the following party on this 26th day of September 2019.

Hon. Kent Chandler
Office of the Attorney General
Utility Intervention and Rate Division
700 Capital Avenue, Ste. 20
Frankfort, Kentucky 40601

Rocco O. D'Ascenzo

VERIFICATION

State of North Carolina)
) SS:
County of Mecklenburg)

The undersigned, Reem H. Grammatico being duly sworn, deposes and says that she is the Director of Corporate Accounting and that the matters set forth in the foregoing Application are true and correct to the best of her information, knowledge and belief.

Reem H. Grammatico

Reem H. Grammatico, Affiant

Subscribed and sworn to me by Reem H. Grammatico on this 23 day of Sept., 2019.

VIRGINIA M. ADAMS NOTARY PUBLIC MECKLENBURG COUNTY, NC EXP. 10/02/2021

Virginia M. Adams

NOTARY PUBLIC

My Commission expires: 10/2/21