VERIFICATION

STATE OF NORTH CAROLINA	)	
	)	**SS:**
COUNTY OF MECKLENBURG	)	

The undersigned, Chris Bauer, Director Corporate Finance – Asset Treasurer, being duly sworn, deposes and says that he has personal knowledge of the matters set forth in the foregoing data requests, and that the answers contained therein are true and correct to the best of his knowledge, information and belief.

Chris Bauer, Affiant

Subscribed and sworn to before me by Chris Bauer on this 27th day of October, 2022.

VIRGINIA M. ADAMS
My Comm. Expires
NOTARY PUBLIC
October 2, 2026
MECKLENBURG COUNTY, NC

Virginia M. Adams
NOTARY PUBLIC

My Commission Expires: 10/2/26

KyPSC Case No. 2022-00335
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Duke Energy Kentucky
Case No. 2022-00335
STAFF First Set Data Requests
Date Received: October 21, 2022

STAFF-DR-01-001

REQUEST:

Refer to the Application, Method of Transacting Capital Leases, page 4. To effectuate a lease transaction in the case of existing property, Duke Kentucky will sell the property to a third-party finance lessor and simultaneously lease the property back from the lessor.

a. Explain why Duke Kentucky would sell existing property to a third-party and lease it back.

b. Explain whether it makes a difference if the property/asset is already in rate base or not

RESPONSE:

a. Sale-leaseback transactions can be structured in several different ways that are advantageous for both the seller and buyer. If Duke Energy Kentucky were to sell existing property to a third-party finance lessor and lease it back, it would allow the company to convert equity in an existing asset to cash, ultimately improving the company's liquidity. The company would be able to free up capital initially used to build or acquire the asset, while retaining possession and use of the property over the lease term. A sale-leaseback also provides flexibility in comparison to more traditional financing alternatives, such as issuing bonds. A lessee could potentially customize the lease terms for the necessary amount of time and avoid refinancing that may be required with more traditional forms of debt financing. Sale-leaseback financings are not commonly used at any of the Duke Energy entities and would only be considered if the company deems it to be the most efficient form of capital available.

b. Duke Energy Kentucky would not expect any material changes to rate base resulting from a sale-leaseback transaction occurring for an asset already in rate base, however, would have dialogue with the commission and staff to address appropriate rate treatment if this situation were to occur. Duke Energy's capitalization guidelines specify that assets that have been placed in service cannot be capitalized again since this would duplicate the costs already in rate base. Please also note, the lease liability recorded on Duke Energy Kentucky's balance sheet would be included in the company's capital structure and cost of capital.

PERSON RESPONSIBLE: Chris Bauer

STAFF-DR-01-002

REQUEST:

Refer to the Application, Method of Transacting Capital Leases, page 4.

a. Provide examples of the journal entries for the different leasing situations. In the case of an existing property lease back arrangement, explain the differences, if any, in journal entries for property that is and is not in rate base.

b. For each of the examples above, explain the specific advantages to Duke Kentucky and to Duke Kentucky's ratepayers from each set of transactions.

RESPONSE:

a. Please see STAFF-DR-01-002(a) Attachment 1 for the entries to record the fixed asset and to expense it. Please see STAFF-DR-01-002(a) Attachment 2 for the accounting involving the sale of the property/ fixed asset under a sale-leaseback transaction. The accounting under a capital lease is similar to that of a normal capital asset, where a fixed asset is recorded to the balance sheet and expensed over the life of the asset. A portion of the expense is recorded to interest expense, while the other portion is expensed to depreciation (see Example 1 in STAFF-DR-01-002(a) Attachment 1). Certain jurisdictions will record the lease expense based on the nature of the asset. For example, some gas pipeline leases are expensed to fuel expense (see Example 2 in STAFF-DR-01-002(a) Attachment 1).

b. Under each finance lease example, the asset is treated as a capital asset and would be a part of rate base. If accounted for as a debt financed asset, the asset is expensed via interest expense and depreciation, however there are other modes of expense and recovery if deemed appropriate by the commission. Capital leases are not commonly used forms of financing for Duke Energy Kentucky, and the company would only entertain a capital lease if it were the most efficient form of capital available and it benefited the company's customers. Capital lease authorization is being requested in this case only to provide flexibility to Duke Energy Kentucky when considering different financing alternatives.

PERSON RESPONSIBLE: Chris Bauer

Journal Entries for Finance Leases - Example 1

<u>Initial Entry</u>

	Right Of Use Asset	XXXX	
	LT Capital Lease Obligation		XXXX
	Current Capital Lease Obligation		XXXX

<u>Monthly Entries</u>

	Current Capital Lease Obligation	XXXX	
	Payable		XXXX
	Interest Expense	XXXX	
	Current Capital Lease Obligation		XXXX
	Depreciation Expense	XXXX	
	Accumulated Depreciation		XXXX

Note: Above example accounts for finance lease as debt financed assets and expenses the lease over time in a combination of depreciation and interest expense.

Journal Entries for Finance Leases - Example 2

Initial Entry

Right Of Use Asset	XXXX	
LT Capital Lease Obligation		XXXX
Current Capital Lease Obligation		XXXX

Monthly Entries

Lease Expense	XXXX	
Lease ROU Asset		XXXX
Lease Expense	XXXX	
Current Capital Lease Obligation	XXXX	
Cash		XXXX

Note: Above example does not treat finance leases as debt financed asset, but expenses it over time to the account based on the nature of the asset. For gas pipeline leases, they are expensed to fuel expense. For real estate leases, they are expensed to A&G.

Sale Leaseback Example
($ in millions)

As an example, lets assume that the fair value of property A is $34m and that would be the proceeds we would receive if sold with no leaseback agreement. Lets also assume that is the book value of the property at the time of sell. With the leaseback agreement we will only receive $32m in proceeds, but will not pay rent for a two year lease on the property after the sell. Under the accounting guidance if the sales proceeds are less than the fair value of the asset, the difference is recognized as prepaid rent.

Details:

Fair Market Value	$	34
Proceeds	$	32
Lease Payment	$	-

Journal Entries:		Dr.	Cr.
At time of transaction			
	Cash	32	
	Lease ROU	2	
	PPE		34
	Lease Liab		0
Monthly over two year lease			
	Amortization	0.2	
	Lease ROU		0.2

Sale Leaseback Example
($ in millions)

As an example, lets assume that is the book value of the property at the time of sell is $34m and that we receive proceeds of $34m. We will pay nothing for the two year lease, but the market rate of a lease of similar property is $3m. Under the accounting guidance if the present value of the contractual lease payment is less than the present value of the fair market value of the lease payments the ROU asset would be recorded at the FMV of the lease payments and any gain/loss on the transaction adjusted accordingly.

Details:

Book value of PPE	$	34
Proceeds	$	34
FMV of lease payments	$	3
Contractual lease payment	$	-

Journal Entries:		**Dr.**	**Cr.**
At time of transaction			
	Cash	34	
	Lease ROU	3	
	PPE		34
	Lease Liab		0
	Gain on sale		3
Monthly over two year lease			
	Amortization	0.3	
	Lease ROU		0.3

Sale Leaseback Example
($ in whole dollars)

As an example, lets assume that is the book value of the property at the time of sell is $34m and that we receive proceeds of $34m. We will pay FMV for the lease for nine months which for this example we will assume is $50,000/month and that the lease is an operating lease. Under the accounting guidance, the sale of the property is treated in accordance with the sale guidance and the lease is treated in accordance with the lease guidance.

Details:

Book value of PPE	$ 34,000,000
Proceeds	$ 34,000,000
FMV of lease payments	$ 448,131
Contractual lease payment	$ 50,000.0
Interest Rate	1%

Journal Entries:

		Dr.	Cr.
At time of transaction			
	Cash	34,000,000	
	Lease ROU	448,131	
	PPE		34,000,000
	Lease Liab		448,131
Month 1			
	O&M	49,627	
	Lease ROU		49,627
	O&M	373	
	Lease Liab	49,627	
	Cash		50,000
Month 2			
	O&M	49,668	
	Lease ROU		49,668
	O&M	332	
	Lease Liab	49,668	
	Cash		50,000

**Remaining months shown in amortization tab*

Discount Rate	1.00%	Interest Expense	1,869

monthnumber		beg_obligation	int_paid	prin_paid	Lease payment	Principal Only end_obligation	ROU Asset Beginning	ROU Amt	ROU Ending		448,131 Payment PV
1/1/2023	1	448,131	373	49,627	50,000	398,504	448,131	(49,627)	398,504		49,958
2/1/2023	2	398,504	332	49,668	50,000	348,836	398,504	(49,668)	348,836		49,917
3/1/2023	3	348,836	291	49,709	50,000	299,127	348,836	(49,709)	299,127		49,875
4/1/2023	4	299,127	249	49,751	50,000	249,376	299,127	(49,751)	249,376		49,834
5/1/2023	5	249,376	208	49,792	50,000	199,584	249,376	(49,792)	199,584		49,792
6/1/2023	6	199,584	166	49,834	50,000	149,750	199,584	(49,834)	149,750		49,751
7/1/2023	7	149,750	125	49,875	50,000	99,875	149,750	(49,875)	99,875		49,709
8/1/2023	8	99,875	83	49,917	50,000	49,958	99,875	(49,917)	49,958		49,668
9/1/2023	9	49,958	42	49,958	50,000	0	49,958	(49,958)	0		49,627

Duke Energy Kentucky
Case No. 2022-00335
STAFF First Set Data Requests
Date Received: October 21, 2022

STAFF-DR-01-003

REQUEST:

Refer to the Application, Related Agreements, page 4. Explain whether Duke Kentucky's affiliates are non-regulated or are they regulated affiliates in other states. If in other states, explain which of Duke Kentucky's regulated affiliates could be a part of these lease agreements.

RESPONSE:

Duke Energy Kentucky has affiliates that are both non-regulated and regulated in other states. Duke Energy Kentucky does not foresee a scenario under this case in which any affiliates would be a part of these lease agreements, and if they were, Duke Energy has strict policies, Commission-approved service agreements, and relevant state codes of conduct in place that govern the relationships and transactions between and among the Duke Energy affiliates.

PERSON RESPONSIBLE: Chris Bauer

Duke Energy Kentucky
Case No. 2022-00335
STAFF First Set Data Requests
Date Received: October 21, 2022

STAFF-DR-01-004

REQUEST:

Explain whether any of Duke Kentucky's other regulated affiliates have entered into capital lease agreements and, if so, which other affiliates and whether regulatory approval was required.

RESPONSE:

Yes. Duke Energy Kentucky's regulated affiliates have entered into various capital lease agreements. Pipeline and building leases are two examples of capital lease arrangements currently in the Duke Energy portfolio. Duke Energy Carolinas, Duke Energy Progress, Duke Energy Florida, and Duke Energy Indiana are regulated affiliates of Duke Energy Kentucky that have entered into capital leases. Similar to the process in Kentucky, pre-approval of entering into capital leases is sought via periodic financing applications. In North Carolina, South Carolina, Indiana, and Ohio, approval to enter into capital leases is specifically sought in each state's financing application and authorization is granted up to a stated dollar amount and over a specified period of time. In Florida, while capital lease approval is not specifically requested in the application or granted in the financing authority, Duke Energy Florida does seek approval to enter into "other obligations."

PERSON RESPONSIBLE: Chris Bauer

Duke Energy Kentucky
Case No. 2022-00335
STAFF First Set Data Requests
Date Received: October 21, 2022

STAFF-DR-01-005

REQUEST:

Refer to the Application, Exhibit A.

a. Explain how capital leasing can be used to fund construction expenditures.

b. Define "other general corporate purposes."

c. Explain whether the lessor could be a non-regulated Duke Kentucky affiliate.

RESPONSE:

a. Capital leasing is not a vehicle that can be used to directly fund construction expenditures. Rather, it can be structured as a way to recover an investment more quickly, or as a means to refinance a construction expenditure.

b. "Other general corporate purposes" is a catchall phrase, commonly found in the use of proceeds section of various debt and equity financing documents (such as a prospectus) that generically describes the normal, more routine cash outflows of a company such as payments for working capital, operating expenses, and capital expenditures.

c. Duke Energy Kentucky does not anticipate, in this case, that the lessor under a capital leasing arrangement would be a non-regulated affiliate of the company. However, under such a scenario, as described in the response to STAFF-DR-01-003, there are strict policies in place that govern the relationships and transactions between and among the Duke Energy affiliates.

PERSON RESPONSIBLE: Chris Bauer

STAFF-DR-01-006

REQUEST:

Provide the number of times Duke Kentucky has solicited a capital lease since case the last capital lease case, Case No. 2020-00322.[1] Provide the type of assets, and an explanation of why Duke chose not to enter into a capital lease.

RESPONSE:

Duke Energy Kentucky has not solicited a capital lease since Case No. 2020-00322, nor are there any immediate plans to do so. Duke Energy Kentucky is seeking authority to enter into capital leases in this application in order to provide flexibility when considering various financing alternatives.

PERSON RESPONSIBLE: Chris Bauer

[1] Case No. 2020-00322, *Electronic Application of Duke Energy Kentucky, Inc. for an Order to Enter Into Up to $25,000,000 Principal Amount of Capital Lease Obligations* (Ky. PSC Nov. 30, 2020).