COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE ELECTRONIC APPLICATION OF DUKE ENERGY KENTUCKY, INC., FOR: 1) AN ADJUSTMENT OF THE ELECTRIC RATES; 2) APPROVAL OF NEW TARIFFS; 3) APPROVAL OF ACCOUNTING PRACTICES TO ESTABLISH REGULATORY ASSETS AND LIABILITIES; AND 4) ALL OTHER REQUIRED APPROVALS AND RELIEF.	)))))))	CASE NO. 2024-00354

REBUTTAL TESTIMONY OF

MICHAEL J. ADAMS

ON BEHALF OF

DUKE ENERGY KENTUCKY, INC.

April 9, 2025

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael J. Adams. My business address is 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. ARE YOU THE SAME MICHAEL J. ADAMS THAT PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THIS REGULATORY PROCEEDING?

A. Yes, I am. I submitted Direct Testimony on behalf of Duke Energy Kentucky, Inc. (Duke Energy Kentucky or the Company) on December 2, 2024.

II. PURPOSE OF REBUTTAL TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimonies of The Office of the Attorney General of the Commonwealth of Kentucky (AG) witnesses Lane Kollen and Randy Futral as such testimonies pertain to Duke Energy Kentucky's cash working capital (CWC) study and the Company's CWC requirements.

III. RESPONSE TO AG WITNESS KOLLEN

Q. HAS AG WITNESS KOLLEN PROPOSED CERTAIN ADJUSTMENTS TO THE COMPANY'S CWC STUDY THAT YOU PREPARED AND SPONSORED IN YOUR DIRECT TESTIMONY?

A. Yes, he has.

Q. PLEASE GENERALLY IDENTIFY THE NATURE OF THE ADJUSTMENTS TO THE COMPANY'S REQUESTED LEVEL OF CWC THAT MR. KOLLEN HAS PROPOSED.

A. Mr. Kollen has proposed the following modifications to the Company's CWC study:

a) The inclusion of long-term debt interest expense in the CWC calculation;[1]

b) The exclusion of other "non-cash" expenses (i.e., non-cash coal fuel expense and the "non-cash" lime expense) that are used from the inventories included in rate base. These other non-cash expenses also include the amortization of prepayments recorded on the balance sheet."[2]

c) A recommendation that the Commission find the Company's termination of the receivables financing program in the base year was imprudent, unreasonable, and harmful to customers. Mr. Kollen further recommends that the Commission exclude recovery of the additional cost included in the revenue requirement resulting from the Company's decision to terminate the receivables financing program, and that the Company reinstate the receivables program to avoid the harm it seeks to impose on its customers through its decision.[3]

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[1] Direct Testimony of Lane Kollen, p. 4, lines 12-16.
[2] *Id*., pp. 4-5, beginning at line 17.
[3] *Id*., p. 5, lines 6-16.

Q. ARE YOU ADDRESSING EACH OF THE MODIFICATIONS TO THE COMPANY'S CASH WORKING CAPITAL STUDY THAT MR. KOLLEN IS PROPOSING?

A. No, I am not. Company witness Heath will address Mr. Kollen's proposed adjustment with respect to the Company's now terminated accounts receivable securitization financing program.

Q. **IN HIS DIRECT TESTIMONY, DOES MR. KOLLEN ARGUE THAT THE CWC CALCULATION SHOULD NOT INCLUDE NON-CASH EXPENSES?**

A. Yes, he does.[4] The effects of this recommendation are reductions in cash working capital and rate base of $5.133 million and a reduction of $0.512 in the revenue requirement.

Q. DO YOU AGREE WITH MR. KOLLEN'S RECOMMENDATION TO REMOVE THE COAL FUEL AND LIME EXPENSES FROM THE DETERMINATION OF THE COMPANY'S CASH WORKING CAPITAL REQUIREMENT?

A. I do not.

Q. ARE THE COAL FUEL AND LIME EXPENSES INCLUDED IN THE CWC CALCULATION CONSIDERED NON-CASH ITEMS?

A. No. The Company expends cash at the time of purchase for coal and lime, and the CWC requirement for these items reflects the actual cash outlays made during the study period.

[4] Direct Testimony and Exhibits of Lane Kollen, beginning at pp. 22, p. 6 through p. 2y, line 3.

Q. IN HIS DIRECT TESTIMONY, DOES MR. KOLLEN ARGUE THAT THE CWC CALCULATION SHOULD NOT INCLUDE THE AMORTIZATION OF PREPAYMENTS?

A. Yes, he does.

Q. DOES THE CWC CALCULATION INCLUDE THE AMORTIZATION OF PREPAYMENTS AS MR. KOLLEN IS SUGGESTING?

A. No, it does not.

Q. PLEASE EXPLAIN.

A. Mr. Kollen is suggesting that the CWC calculation includes the amortization of prepayments recorded on the balance sheet. In actuality, the amortization of prepayments recorded on the balance sheet was not included in the CWC calculation. The amortization of prepayments that Mr. Kollen is alluding to is representative of the assessment paid to the Public Service Commission and actual insurance premiums paid during the study period.

Q. BASED UPON YOUR CLARIFICATION, DO YOU AGREE WITH MR. KOLLEN'S POSITION? PLEASE EXPLAIN.

A. I do not. The amortization of prepayments was not included in the CWC calculation as Mr. Kollen has suggested.

Q. DOES AG WITNESS KOLLEN ALSO PROPOSE THAT THE COMPANY'S LONG-TERM DEBT INTEREST EXPENSE SHOULD HAVE BEEN REFLECTED IN THE CASH WORKING CAPITAL ANALYSIS?

A. Yes, he does. Mr. Kollen recommended that the Commission include long-term debt interest expense because Duke Energy Kentucky utility affiliates in another jurisdiction, such as North Carolina, and Kentucky Power Company have included long-term debt interest expense in their cash working capital analysis. The effects of this recommendation are reductions in cash working capital and rate base of $2.937 million and a reduction of $0.293 in the revenue requirement.

Q. DO YOU AGREE WITH MR. KOLLEN'S RECOMMENDATION?

A. No, for two reasons. First, Mr. Kollen's proposal is inconsistent with the Company's prior approved lead-lag study, which excluded interest expense and that I have adhered to in the proceeding. Second, while operating income (from which interest expense is paid) has been treated differently in the lead-lag study in U.S. jurisdictions (including by the Commission), there is a theoretical basis for its exclusion from the lead-lag study that I will describe below.

Q. WHAT IS THE THEORETICAL BASIS UPON WHICH OPERATING INCOME (FROM WHICH INTEREST EXPENSE IS PAID) IS EXCLUDED FROM THE LEAD-LAG STUDY?

A. In *Accounting for Public Utilities*, Hahne describes lead-lag approaches to "funds relating to net operating income," including interest expense. Specifically, Hahne states:

> The treatment of funds relating to net operating income is subject to a wide difference of opinion in the evaluation of lead-lag study procedures. From a theoretical standpoint, operating income is earned when service is provided, and the operating income is the property of the investors in the company when earned. This view would recognize a cash working capital requirement for the lag in receipt of operating income. Such a requirement is equal to the revenue lag days multiplied by an amount equal to one day's operating income. The amount for interest or preferred dividends would not be offset, because those amounts are paid from funds belonging to investors (operating income).
>
> At the opposite end of the spectrum, on occasion parties have suggested that a source of cash working capital exists in the delay in disbursement of interest, preferred dividends, and dividends on common equity. Few commissions have accepted either of these opposing points of view. Usually, the decisions are somewhere between the two poles. ***The most prevalent is probably to not consider the operating income component in the lead-lag study, which results in not recognizing a need for cash working capital to cover operating income and not recognizing accruals of interest and preferred dividends as a source of cash working capital***. The procedure of ignoring operating income generally produces approximately the same effect as does the procedure of recognizing the lag in collecting the equity return component of operating income while also recognizing a lag in the payment of interest expense and preferred dividends. Many commissions considering the question have adopted one of these latter two methodologies.[5]

In other words, (a) the approved approach used in the Company's last rate case and adhered to in this proceeding is "the most prevalent," and (b) even if interest expense is included in the lead-lag study, it is only as an offset to the lag on operating income, which *increases* cash working capital.

[5] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities § 5.04[2][b][vii] (2022). ***Emphasis added***.

Q. IS MR. KOLLEN'S PROPOSAL CONSISTENT WITH PRIOR COMMISSION PRECEDENT?

A. With respect to interest expense in the cash working capital analysis, the Kentucky Public Service Commission approved the inclusion of interest expense in Kentucky Power's most recent base rate case proceeding, Case No. 2023-00159.

Q. IS MR. KOLLEN'S PROPOSAL CONSISTENT WITH KENTUCKY PUBLIC SERVICE COMMISSION DECISIONS PERTAINING TO DUKE ENERGY KENTUCKY?

A. No. The cash working capital analysis approved in the Company's previous base rate case proceeding, Case No. 2022-00372, did not include interest expense.

Q. WHEN PREPARING A CASH WORKING CAPITAL STUDY DO YOU ATTEMPT TO FOLLOW PRIOR REGULATORY PRECEDENT ALLOWED BY THE STATE REGULATOR FOR THE UTILITY IN PRIOR RATE PROCEEDINGS, WHEN POSSIBLE?

A. Yes, I do. When preparing the lead-lag study for Duke Energy Kentucky for this rate proceeding, I confirmed that the Kentucky Public Service Commission had in prior rate proceedings excluded long-term interest expense from the determination of Duke Energy Kentucky's cash working capital requirement. As such, I proposed a similar treatment in this current proceeding.

Q. PLEASE EXPLAIN.

A. For regulatory and ratemaking consistency purposes, I attempt to follow established precedent, when and where possible, to minimize the rehashing of decided issues. The Kentucky Public Service Commission approved the cash working capital study that did not include interest expense in the Company's most recent base rate case proceeding, Case No. 2022-00372. Given that the treatment had been recently decided, I prepared Duke Energy Kentucky's cash working capital study in a similar manner. As previously stated, the most prevalent approach to a cash working capital study is to not consider the operating income component in the lead lag study, which results in not recognizing a need for cash working capital to cover operating income and interest as a source of cash working capital.

IV. RESPONSE TO AG WITNESS FUTRAL

Q. WHAT ADJUSTMENTS DOES AG WITNESS FUTRAL PROPOSE, AS THEY PERTAIN TO DUKE ENERGY KENTUCKY'S CASH WORKING CAPITAL STUDY?

A. AG witness Futral opines that "The 2023 combined electric and gas division receivables data relied upon by the Company in the lead/lag study was highly impacted by the short-term spike in natural gas commodity prices prior to the start of 2023." He further alleges that "the 2024 data is more reasonable and recurring level of historic collection data that should be used to set the level of collection lag days." Based upon his assertion, Mr. Futral recommends that the Commission utilize the 2024-only collection lag days of 23.15 days instead of the filed 2023-only collection lag days of 26.66 days.[6] The effects of this recommendation are reductions in cash working capital and rate base of $2.894 million and a reduction of $0.289 in the revenue requirement.

[6] Direct Testimony and Exhibits of Randy A. Futral, p. 16, lines 11-18.

Q. IS MR. FUTRAL'S ADJUSTMENT APPROPRIATE?

A. No, it is not. Further, Mr. Futral provides no basis or support for his assessment that the Company's collection lag of 26.66 days is unreasonable. Nor does Mr. Futral provide support for his determination that the 2024 collection lag is "more reasonable." Mr. Futral merely identifies a single component of the working capital study and proposes to adjust that element of the study with data from a period outside of the period used for cash working capital study. Several factors impact the collection lag, and, as Mr. Futral acknowledges, the single factor he has identified affects both natural gas and electric customers.[7] Further, any purported differences in electric versus natural gas collections lags is not solved by simply choosing another timeframe over which to analyze data. A cash working capital study, as well as a rate test year should adhere to the matching principle unless there are anomalous conditions that overwhelm the general principle of relying on a matching period for the purposes of analyzing leads and lags. The collection lag should not be arbitrarily singled out and adjusted to reflect a different period of time. Mr. Futral's proposed adjustment ignores the matching concept of a study period, and if the study period needs to be adjusted, both the revenue lag and expense leads should be adjusted to reflect matching time periods. The analyses should not reflect an analysis of mismatched periods as Mr. Futral appears to propose and should not single out one data point simply for the purpose of delivering a lower result.

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[7] *Id.*, at 15.

Q. WHAT JUSTIFICATION DOES AG WITNESS FUTRAL OFFER IN SUPPORT OF HIS PROPOSED ADJUSTMENT?

A. Mr. Futral claims that customer bills increased substantially during the study period due to high gas prices and receivable balances. He opines that his recommendation "decreases the combined collection lag days of 26.66," but fails to acknowledge that while gas prices may have increased the Company's receivable balances, it is not the only factor that influences the Company's collection lag, and just because this adjustment decreased a portion of the rate filing is not a reason to propose, or accept, such an adjustment.

Q. SHOULD THE COMMISSION ADOPT MR. FUTRAL'S PROPOSAL TO UTILIZE TWO DIFFERENT TIME PERIODS FOR REVENUES AND EXPENSES CONSIDERED IN THE DETERMINATION OF THE CASH WORKING CAPITAL ALLOWANCE?[8]

A. No. Based upon my experience, I am of the opinion that Mr. Futral's recommendation should be rejected, and that the Company's proposed collection lag of 26.66 days should be adopted by the Commission.[9]

Ratemaking in general, and specifically a lead-lag study, are designed to analyze the timing of cash flows, both of revenues and expenses from a specific period of time. Mr. Futral's proposed adjustment arbitrarily adjusts one portion of the equation (i.e., cash flows associated with revenues) and subjectively reduces the collection lag. He provides no details as to what changes may be required to be

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[8] *Id.*, p. 16, lines 9-11.

[9] It has been determined that the proposed collection lag of 26.66 days was understated. The Company is not proposing to update the collection lag in this proceeding.

made to the expense leads. Further, Mr. Futral fails to address and/or discuss whether the Company's payment patterns may have changed from calendar year 2023 to calendar year 2024.

The Company's cash working capital analyses properly reflects a balancing of the actual cash receipts and cash payments from calendar year 2023. Mr. Futral's proposed adjustment, which considers some data from 2023 and other data from 2024 creates an imbalance between cash inflows and outflows and should be rejected.

To avoid the imbalance, if the collection lag is modified, all aspects of the CWC study should be updated.

V. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?

A. Yes, it does.