

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke)
Energy Ohio, Inc., for the Establishment)
of a Charge Pursuant to Revised Code) Case No. 12-2400-EL-UNC
Section 4909.18.)

In the Matter of the Application of Duke)
Energy Ohio, Inc., for Approval to) Case No. 12-2401-EL-AAM
Change Accounting Methods.)

In the Matter of the Application of Duke)
Energy Ohio, Inc., for the Approval of a) Case No. 12-2402-EL-ATA
Tariff for a New Service.)

DIRECT TESTIMONY OF

WILL A. GARRETT

ON BEHALF OF

DUKE ENERGY OHIO, INC.

_____ Management policies, practices, and organization
_____ Operating income
_____ Rate base
_____ Allocations
_____ Rate of return
_____ Rates and tariffs
 X Other: Deferral request

March 1, 2013

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I. INTRODUCTION AND PURPOSE

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Will A. Garrett. My business address is 550 South Tryon Street, Charlotte,
3 NC 28202.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by Progress Energy Service LLC (PES), as Director of Accounting
6 Research for Duke Energy Corporation (Duke Energy). PES, which was the service
7 company for the former Progress Energy Corp., now provides various administrative and
8 other services to affiliated companies of Duke Energy.

9 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
10 **PROFESSIONAL EXPERIENCE.**

11 A. I joined Duke Energy in July of 2012 as part of the merger with Progress Energy, Inc.
12 (Progress Energy). Prior to this role, I was with Progress Energy as the company
13 Controller for Progress Energy Florida, having joined Progress Energy on November 7,
14 2005. As the Controller for Progress Energy Florida, I provided testimony on a variety of
15 regulatory accounting matters before the Florida Public Service Commission, in
16 connection with regulatory cost recovery clauses and general base rate proceedings. My
17 other direct relevant experience includes over two years as the Corporate Controller for
18 DPL, Inc., and its major subsidiary, The Dayton Power and Light Company,
19 headquartered in Dayton, Ohio. Prior to this position, I held a number of finance and
20 accounting positions for eight years at Niagara Mohawk Power Corporation, Inc.,
21 (NMPC) in Syracuse, New York, including Executive Director of Financial Operations,
22 Director of Finance, and Assistant Controller. As the Director of Finance and Assistant

1 Controller, my responsibilities included regulatory proceedings, rates, financial planning,
2 and providing testimony on a variety of matters before the New York Public Service
3 Commission. Prior to joining NMPC, I was a Senior Audit Manager at Price Waterhouse
4 (PW) in upstate New York, with 10 years of direct experience with investor-owned
5 utilities and publicly traded companies. I graduated from the State University of New
6 York in Binghamton, with a Bachelor of Science in Accounting, in 1981 and I am a
7 Certified Public Accountant in the State of New York.

8 **Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AS DIRECTOR OF**
9 **ACCOUNTING RESEARCH.**

10 A. As Director of Accounting Research for Duke Energy, I am responsible for all material
11 accounting matters that impact the reported financial results of the consolidated Duke
12 Energy entity. I have direct management and oversight of director and manager level
13 employees supporting a wide variety of complex accounting matters; including, but not
14 limited to, regulatory accounting, mergers and acquisitions, derivative and fair value
15 accounting, goodwill valuations and general accounting matters.

16 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES**
17 **COMMISSION OF OHIO?**

18 A. No, I have not.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?**

20 A. The purpose of my testimony is to explain the Company's deferral request and its
21 compliance with generally accepted accounting principles.

II. DISCUSSION

1 **Q. PLEASE DESCRIBE THE DEFERRED REQUEST THAT THE COMPANY HAS**
2 **INCLUDED IN THESE PROCEEDINGS.**

3 A. As more thoroughly discussed by Duke Energy Ohio witnesses B. Keith Trent and
4 William Don Wathen Jr., the Company is seeking the establishment of a charge for the
5 noncompetitive, wholesale capacity services that it is providing consistent with its
6 obligations as a fixed resource requirement (FRR) entity in PJM Interconnection, L.L.C.
7 (PJM). The period for which this charge would apply is August 1, 2012, through May 31,
8 2015. Additionally, Duke Energy Ohio is seeking authority to create a regulatory asset
9 and defer, for future recovery, the difference between its cost-based charge and market-
10 based pricing it receives from PJM. Specific to the deferred amounts, Duke Energy Ohio
11 is also requesting approval to establish a rider – initially set at zero – pursuant to which
12 said amounts would subsequently be collected.

13 **Q. WHAT ARE GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND**
14 **HOW ARE THEY RELEVANT TO THE DEFERRAL REQUEST PROPOSED IN**
15 **THESE PROCEEDINGS?**

16 A. Generally Accepted Accounting Principles (GAAP) are the accounting rules used to
17 prepare and report financial statements for publicly held companies in the United States.
18 The primary rulemaking body for the accounting rules that public companies comply
19 with is the Financial Accounting Standards Board (FASB). The FASB's Accounting
20 Standards Codification (ASC) 980, *Regulated Operations*, applies to an entity that has
21 regulated operations that meet all of the following criteria, from ASC 980-10-15-2,
22 formerly Financial Accounting Standards No. 71 or FAS 71:

1 a. The entity's rates for regulated services or products provided to its
2 customers are established by or are subject to approval by an independent,
3 third-party regulator or by its own governing board empowered by statute
4 or contract to establish rates that bind customers.

5 b. The regulated rates are designed to recover the specific entity's costs of
6 providing the regulated services or products. This criterion is intended to
7 be applied to the substance of the regulation, rather than its form. If an
8 entity's regulated rates are based on the costs of a group of entities and the
9 entity is so large in relation to the group of entities that its costs are, in
10 essence, the group's costs, the regulation would meet this criterion for that
11 entity.

12 c. In view of the demand for the regulated services or products and the
13 level of competition, direct and indirect, it is reasonable to assume that
14 rates set at levels that will recover the entity's costs can be charged to and
15 collected from customers.

16 ASC 980 further clarifies that entities subject to the rules included in ASC 980 should
17 apply ASC 980-10-15-2 rather than any conflicting provisions of other parts of the
18 Accounting Standards Codification.

19 ASC 980-340-25-1 describes when a regulatory asset should be recognized, as
20 follows:

21 **25-1** Rate actions of a regulator can provide reasonable assurance of the
22 existence of an asset. An entity shall capitalize all or part of an incurred
23 cost that would otherwise be charged to expense if both of the following
24 criteria are met:

25 a. It is probable that future revenue in an amount at least equal to
26 the capitalized cost will result from inclusion of that cost in
27 allowable costs for rate-making purposes.

28 b. Based on available evidence, the future revenue will be provided
29 to permit recovery of the previously incurred cost rather than to
30 provide for expected levels of similar future costs.

31 A cost that does not meet these asset recognition criteria at the date the
32 cost is incurred shall be recognized as a regulatory asset when it does meet
33 those criteria at a later date.

1 **Q. ARE YOU FAMILIAR WITH THE COMPANY'S REQUEST IN THESE**
2 **PROCEEDINGS?**

3 A. Yes. I have reviewed the revenue requirement calculations provided in the Application
4 and sponsored by Mr. Wathen.

5 **Q. WILL YOU DESCRIBE THE ACCOUNTING DEFERRALS THAT WILL BE**
6 **RECORDED IF THE COMMISSION GRANTS THE COMPANY'S REQUEST IN**
7 **THIS APPLICATION?**

8 A. Per ASC 980-10-15-2, the Company will, with one exception, defer the difference
9 between its cost of providing noncompetitive, wholesale capacity service pursuant to its
10 FRR obligation and the market-based revenue it is currently receiving from PJM for that
11 obligation. Costs associated with providing noncompetitive FRR capacity service
12 include operating and maintenance expenses, depreciation, property taxes, other taxes,
13 and interest expense.

14 GAAP, specifically ASC 980 discussed above, does not allow deferral of the
15 return on equity portion of a utility's cost of operations but do allow deferral of all other
16 costs not being recovered by current revenue. In compliance with this rule, the return on
17 equity component will be deferred for future recovery in rates but not recognized in
18 reported income during the deferral period for accounting purposes. Rather, the benefit of
19 the recovery of the return on equity will be recognized when incorporated into future
20 rates and recovered from customers. Therefore the return on equity being deferred for
21 future recovery will not have an earnings impact on Duke Energy Ohio until that time.

1 **Q. IS THE COMPANY CURRENTLY USING REGULATORY ACCOUNTING FOR**
2 **ITS GENERATION BUSINESS?**

3 A. No.

4 **Q. TO YOUR KNOWLEDGE, IS THERE ANY PROVISION IN GAAP OR ANY**
5 **REGULATORY REASON THE COMPANY CANNOT RESUME USING**
6 **REGULATORY ACCOUNTING FOR ITS GENERATION BUSINESS?**

7 A. ASC 980-20 (formerly part of Financial Accounting Standards No. 101, or FAS 101)
8 specifies how an enterprise that ceases to meet the criteria for the application of
9 regulatory accounting (that is, ASC 980-10 – formerly FAS71) with regard to all or part
10 of its operations should report the event in its U.S. GAAP financial statements. FAS 101
11 contains no prohibition on resuming the use of regulatory accounting. Therefore, if a
12 deregulated enterprise experiences “re-regulation” such that it again meets the three
13 criteria for “initial and continuing application” of ASC 980-10, regulatory accounting
14 should be “reapplied to all or a separable portion of operations.”¹ If Duke Energy Ohio’s
15 Application is approved, the Commission will have established that the wholesale
16 capacity service at issue in these proceedings is a “non-competitive” service and qualifies
17 for the application of regulatory accounting.

18 **Q. IS THE COMPANY REQUESTING TO DEFER REVENUE FOR FUTURE**
19 **RECOVERY?**

20 A. No. As described above, the Company is only requesting to defer the difference between
21 actual costs and the revenue received from PJM. The accounting authority being sought
22 in these proceedings is to defer costs. As described by Duke Energy Ohio witness

¹ PWC Accounting and Reporting Manual, dated July 19, 2011, section .14, Reapplication of the Regulated Operations Topic.

1 Wathen, the Company is incurring, and will continue to incur, costs in connection with its
2 FRR obligations. And as Mr. Wathen further explains, these costs include, but are not
3 limited to, operating and maintenance expense, depreciation, and interest that are not
4 currently being recovered.

III. CONCLUSION

5 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

6 A. Yes.