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Deputy General Counsel

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December 30, 2016

VIA ELECTRONIC FILING

M. Lynn Jarvis
Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4300

RE: Duke Energy Progress, LLC and Duke Energy Carolinas, LLC's Petition for an Accounting Order
Docket Nos. E-2, Sub 1103 and E-7, Sub 1110

Dear Ms. Jarvis:

Enclosed please find Duke Energy Progress, LLC and Duke Energy Carolinas, LLC's Petition for an Accounting Order, for filing in the above-referenced matter.

Please contact me if you have any questions.

Sincerely,

Heather Shirley Smith

Heather Shirley Smith

Enclosure

cc: Parties of Record

I/A

CERTIFICATE OF SERVICE

I certify that a copy of Duke Energy Progress, LLC and Duke Energy Carolinas, LLC's Petition for an Accounting Order, in Docket Nos. E-2, Sub 1103 and E-7, Sub 1110, has been served by electronic mail, hand delivery or by depositing a copy in the United States mail, postage prepaid, properly addressed to parties of record.

This is the 30th day of December, 2016.

By: Heather Shirley Smith

Heather Shirley Smith
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I/A

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-2, SUB 1103
DOCKET NO. E-7, SUB 1110

In the Matter of	)	
	)	
Joint Petition of Duke Energy Progress, LLC and Duke Energy Carolinas, LLC for an Accounting Order to Defer Environmental Compliance Costs	)	**DUKE ENERGY PROGRESS, LLC AND DUKE ENERGY CAROLINAS, LLC PETITION FOR AN ACCOUNTING ORDER**

Pursuant to North Carolina Utilities Commission (the "Commission") Rules R1-5 and R8-27, Duke Energy Progress, LLC ("DEP") and Duke Energy Carolinas, LLC ("DEC") (collectively, the "Companies") respectfully petition the Commission to issue an accounting order for regulatory accounting purposes authorizing the Companies to defer in a regulatory asset account (until the Companies' next base rate cases) certain costs incurred in connection with compliance with federal and state environmental requirements as it relates to Coal Combustion Residuals ("CCRs" or "coal ash").

Executive Summary

The Companies are making substantial progress in safely managing coal ash and closing ash basins across the Carolinas in compliance with state and federal law, and have been transparent about our accounting for all costs associated with this important work. In this Petition, the Companies do not seek a change in customer rates; rather, this Petition requests an accounting order such that the Companies' compliance costs may be deferred in a regulatory asset account for review in a future setting, such as a rate proceeding. Through such a proceeding, the Commission may consider such costs in broad scope, including such factors as (1) the prudency of the Companies' activities in complying with legal requirements; (2) the appropriate cost of service allocation; (3)

earnings impact, and (4) the length of amortization schedule to mitigate rate impact.

Expenses incurred for state and federal compliance and requested for deferral (January 2015 - November 2016) include $434.4 million for DEC and $291.9 million for DEP. No fines or penalties, or costs associated with the Dan River pipe break repair and resulting spill cleanup, are included in these amounts nor will be sought for rate recovery at a later date.

Closing ash basins is part of the life cycle of the Companies' coal plants, and compliance with state and federal regulatory requirements is part of the normal operation of a utility. Costs related to the operation of a power plant, including decommissioning costs, are typically paid for by customers. Ultimately, the Commission will determine how costs associated with ash management and basin closure will be handled through the robust and public ratemaking process. As explained below, while recovery of this type of cost is consistent with the precedent in North Carolina, the magnitude, scope, duration and complexity of compliance is extraordinary and unprecedented. As such, the Companies respectfully request the relief granted in this Petition so that all complexities may be adequately reviewed by the Commission and stakeholders at an appropriate time.

In support of this Petition, the Companies respectfully present the Commission the following:

Name and Address of Duke Energy Progress

1. The correct name and post office address of the Company are:

Duke Energy Progress, LLC
410 S. Wilmington Street, NCRH 20
Raleigh, North Carolina 27601

Name and Address of Duke Energy Carolinas

Duke Energy Carolinas, LLC
P.O. Box 1006
Charlotte, North Carolina 28201-1006

Notices and Communications

2. The names and addresses of the attorneys of the Companies who are authorized to receive notices and communications with respect to this petition are:

Heather Shirley Smith, Esq.
Deputy General Counsel
Duke Energy Corporation
40 W. Broad Street, Suite 690
Greenville, South Carolina 29601

and

Lawrence B. Somers, Esq.
Deputy General Counsel
Duke Energy Corporation
410 S. Wilmington Street, NCRH 20
Raleigh, North Carolina 27602-1151

Description of the Companies

3. DEP is engaged in the generation, transmission, distribution, and sale of electric energy at retail in portions of western, central, and eastern North Carolina and the eastern portion of South Carolina. DEP also sells electricity at wholesale to municipal, cooperative and investor-owned electric utilities, and its wholesale sales are subject to the jurisdiction of the Federal Energy Regulatory Commission. DEP is a public utility under

the laws of North Carolina and is subject to the jurisdiction of this Commission with respect to its operations in this State. DEP is also authorized to transact business in the State of South Carolina and is a public utility under the laws of that State. Accordingly, its operations in that State are subject to the jurisdiction of the Public Service Commission of South Carolina.

4. DEC is engaged in the generation, transmission, distribution, and sale of electric energy at retail in the central and western portions of North Carolina and the western portion of South Carolina. DEC also sells electricity at wholesale to municipal, cooperative and investor-owned electric utilities, and its wholesale sales are subject to the jurisdiction of the Federal Energy Regulatory Commission. DEC is a public utility under the laws of North Carolina and is subject to the jurisdiction of this Commission with respect to its operations in this State. DEC is also authorized to transact business in the State of South Carolina and is a public utility under the laws of that State. Accordingly, its operations in that State are subject to the jurisdiction of the Public Service Commission of South Carolina.

Environmental Requirements

5. On April 17, 2015, the Environmental Protection Agency ("EPA") published in the Federal Register a rule to regulate the disposal of CCRs from electric utilities as solid waste. The federal regulation classifies CCR as nonhazardous waste under Subtitle D of the Resource Conservation and Recovery Act and allows beneficial use of CCRs with some restrictions. The regulation[1] applies to all new and existing landfills, new and existing surface impoundments, structural fills and CCR piles. The

[1] See Hazardous and Solid Waste Management System: Disposal of Coal Combustion Residuals from Electric Utilities, promulgated by the EPA and published on April 17, 2015, in 80 Fed Reg. 21302.

federal CCR rule establishes requirements regarding landfill design; structural integrity design and assessment criteria for surface impoundments; groundwater monitoring and protection procedures; and other operational and reporting procedures to ensure the safe disposal and management of CCR. In addition to the requirements of the federal CCR regulations, CCR landfills and surface impoundments will continue to be independently regulated by the State through operating permits and environmental requirements.

6. In accordance with ASC 410-20, Asset Retirement and Environmental Obligations – Asset Retirement Obligations, each of DEC and DEP record an asset retirement obligation ("ARO") when there is a legal obligation to incur retirement costs associated with the retirement of a long-lived asset and the obligation can be reasonably estimated. These accounting requirements dictate the measurement and recognition of AROs for companies in general. The Commission has also issued orders requiring the Companies to defer all impacts of other AROs until those costs can be considered in future rate making decisions.[2] In addition, DEP's rates currently include a component for ash remediation costs as a part of Cost of Removal included in depreciation rates; however, only a small balance has been collected for this matter since DEP's last retail rate case in North Carolina.

7. On September 20, 2014, the North Carolina Coal Ash Management Act ("CAMA"), 2014 N.C. Sess. Laws 122; 2014 N.C. Ch. 122; 2013 N.C. SB 729, became law and was amended on June 24, 2015, by the Mountain Energy Act, which established

[2] In the Matter of Duke Power's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account, NCUC Docket No. E-7, Sub 723, *Order Granting Motion for Reconsideration and Allowing Deferral of Costs* (August 8, 2003); and In the Matter of Carolina Power & Light Company's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account, NCUC Docket No. E-2, Sub 826, *Order Granting Motion for Reconsideration and Allowing Deferral of Costs* (August 12, 2003).

a Coal Ash Management Commission ("Coal Ash Commission") to oversee handling of coal ash within the State. Through CAMA, the legislature:

(i) prohibited construction of new and expansion of existing ash impoundments and use of existing impoundments at retired facilities;

(ii) required closure of ash impoundments at Duke Energy Progress' Sutton Plant and Duke Energy Carolinas' Riverbend and Dan River stations no later than August 1, 2019 and Duke Energy Progress' Asheville Plant no later than August 1, 2022;

(iii) required dry disposal of fly ash at active plants, excluding the Asheville Plant, not retired by December 31, 2018;

(iv) required dry disposal of bottom ash at active plants, excluding the Asheville Plant, by December 31, 2019, or retirement of active plants;

(v) required all remaining ash impoundments in North Carolina be categorized as high-risk, intermediate-risk or low-risk no later than December 31, 2015 by the North Carolina Department of Environmental Quality ("DEQ", formally known as the North Carolina Department of Environmental and Natural Resources, or "DENR") with the method of closure and timing to be based upon the assigned risk, with closure no later than December 31, 2029;

(vi) established requirements to deal with groundwater and surface water impacts from impoundments; and

(vii) enhanced the level of regulation for structural fills utilizing coal ash.

CAMA included a variance procedure for compliance deadlines and modification of requirements regarding structural fills and compliance boundaries. Duke Energy has and

will periodically submit to DEQ site-specific coal ash impoundment closure plans or excavation plans in advance of closure. These plans and all associated permits must be approved by DEQ before any excavation or closure work can begin. CAMA leaves the decision on cost recovery determinations related to closure of CCR surface impoundments (ash basins or impoundments) to the normal ratemaking processes before utility regulatory commissions. Accordingly, this deferral request will allow the recoverability of these costs to be determined in the context of formal proceedings when rate changes are sought by the Companies.

8. In September 2014, Duke Energy Carolinas executed a consent agreement with the South Carolina Department of Health and Environmental Control ("SCDHEC") requiring the excavation of an inactive ash basin and ash fill area at the W.S. Lee Steam Station. As part of this agreement, in December 2014, Duke Energy Carolinas filed an ash removal plan and schedule with SCDHEC. In April 2015, the federal CCR rules were published, and Duke Energy Carolinas subsequently executed an agreement with the conservation groups Upstate Forever and Save Our Saluda requiring Duke Energy Carolinas to remediate all active and inactive ash storage areas at the W.S. Lee Steam Station. Coal-fired generation at W.S. Lee ceased in 2014, and unit 3 is being converted to natural gas. In July 2015, Duke Energy Progress executed a consent agreement with SCDHEC requiring the excavation of all CCRs at the Robinson Plant site within eight years. The W.S. Lee Station site and the Robinson Plant are required to be closed pursuant to the recently issued CCR rule and/or the provisions of these consent agreements which are consistent with the federal CCR closure requirements described above.

9. CAMA was amended by NC House Bill 630, the Drinking Water Protection and Coal Ash Cleanup Act, which was signed into law by the Governor of North Carolina on July 14, 2016 (the "CAMA Amendment"). The CAMA Amendment imposes requirements on Duke Energy that, if fulfilled, allow Duke Energy more closure options that may be implemented over a longer period of time. The CAMA Amendment requires Duke Energy to provide a permanent water supply to residents with drinking water supply wells located within ½ mile of Duke Energy ash basins and to certain other potentially impacted residents. Additionally, the CAMA Amendment requires Duke Energy to undertake dam improvement projects. Upon satisfactory completion of the dam improvement projects and installation of alternate drinking water sources by October 15, 2018, the legislation requires the DEQ to reclassify sites proposed as intermediate risk (excluding H.F. Lee, Cape Fear and Weatherspoon plants as discussed below), as low risk. The CAMA Amendment also requires excavation of the basins at three DEP facilities (Cape Fear, H.F. Lee, and Weatherspoon stations) based on their statutory classification as "intermediate." Closure of these specific intermediate basins is required to be completed no later than August 1, 2028. Finally, the CAMA Amendment requires the installation and operation of three large-scale coal ash beneficiation projects which are expected to produce reprocessed ash for use in the concrete industry. Closure of basins at sites with these beneficiation projects are required to be completed no later than December 31, 2029. On October 5, 2016, Duke Energy announced Buck Steam Station as a first location for one of the beneficiation projects. On December 13, 2016, Duke Energy Progress announced plans to excavate coal ash from four basins at the H.F. Lee

Plant in Goldsboro, N.C., and to safely recycle the valuable material for use in concrete products.

10. In March 2016, the Coal Ash Management Commission created by the CAMA Amendment was disbanded by the Governor of North Carolina based on a North Carolina Supreme Court ruling regarding the constitutionality of the body.[3] The CAMA Amendment eliminates the Coal Ash Management Commission and transfers responsibility for ash basin closure oversight to the DEQ.

11. AROs recorded on the DEC and DEP Condensed Consolidated Balance Sheets at September 30, 2016 are based upon the legal obligation for closure of coal ash basins and the disposal of related CCRs as a result of the federal and state requirements described above in paragraph 5 in the amount of approximately $2.1 billion for DEC, and approximately $2.4 billion for DEP. Since the initial recognition of these AROs, the Companies have deferred all of the accounting impacts of these obligations for future determination in the next rate case with the exception of items for which a specific recovery mechanism has been established (such as limited recovery for ash reuse through the fuel clauses in North Carolina for DEC and DEP).

12. Accordingly, the total value of the Companies' AROs recorded as of September 30, 2016 related to coal ash basin closure costs to date is approximately $4.5 billion. These AROs are included in the Companies' financials as required by NCUC Docket No. E-7, Sub 723, Order dated August 8, 2003, and NCUC Docket No. E-2, Sub 826, Order dated August 12, 2003. The actual compliance costs incurred may be materially different from these estimates based on the timing and requirements of the

[3] *McCrory v. Berger*, 769 S.E.2d 629, 368 N.C. 253, (N.C. 2015).

final regulations. The Companies spent $434.4 million (DEC) and $291.9 million (DEP) in the period January 1, 2015 through November 30, 2016, related to the AROs.

13. In particular, DEC spent $434.4 million on the following activities: engineering and regulatory compliance activities for all sites; mobilization and start-up of closure activities at Dan River Steam Station and Riverbend Steam Station; building rail infrastructure for basin excavation at Dan River Station; dewatering activities associated with basin closure at Dan River, W.S. Lee and Riverbend stations; and ash excavation at Dan River, W.S. Lee, Cliffside and Riverbend stations of approximately 2.7 million tons.[4]

14. In particular, DEP spent $291.9 million on the following activities: engineering and regulatory compliance activities for all sites; mobilization and start-up of closure activities at Asheville and Sutton plants; building rail infrastructure for ash excavation at Sutton Plant; dewatering activities associated with basin closure at Asheville, Sutton, H.F. Lee and Cape Fear plants; ash excavation at Asheville and Sutton plants of approximately 1.8 million tons; and closure of the 1982 ash basin at Asheville Plant.

Financial Consequences of this Request

15. The Companies have been accounting for the ash basin AROs and expense in the manner detailed in the informational filing made to the Commission on December 21, 2015, which was docketed as Docket Nos. E-2, Sub 1103 and E-7, Sub 1110. That filing is attached to this Petition as Attachment 1. As explained in that filing, the Companies did not file a deferral request at that time due to significant litigation and

[4] Again, no fines, penalties or Dan River pipe break repair or spill cleanup costs are included in these amounts.

reconsiderations related to CAMA, the now-defunct Coal Ash Management Commission, and numerous other outstanding issues that have now been resolved sufficiently, including the passage of the CAMA Amendment, such that the Companies may make this request.

16. The Companies' accounting practices, consistent with generally accepted accounting principles, have resulted in preserving the issue for this Petition. As such, the expense effect of the expenditures incurred from January 1, 2015 to date has been captured in ARO accounting, and the Company's earnings do not reflect the expenses to date.

17. In a recent order, the Commission articulated its general proposition that in assessing the financial consequences of a deferral request as measured by impact to return on equity ("ROE"), adjustments to per-book ROEs should be considered, as well as "noteworthy facts, circumstances, and/or events significantly affecting those ROEs."[5] The Companies show such noteworthy circumstances below, including showing what the ROEs would be if the Commission nullifies the accounting treatment reported to the Commission in these Dockets.

18. DEP reported returns on equity in its E.S.-1 surveillance reports of 10.39% for the 12 months ended September 30, 2016, for its North Carolina retail jurisdiction. The below table shows what these ROEs would be if adjusted for several ratemaking adjustments typically made in a general rate case. The below table also shows the effect of denying this deferral request.

[5] In the Matter of Application by Virginia Electric & Power Company, d/b/a Dominion North Carolina Power, for Accounting Order to Defer Certain Capital and Operating Costs Associated with the Warren County Combined Cycle Addition, *Order Denying Deferral Accounting for Warren County Combined Cycle Generating Facility*, Docket No. E-22, Sub 519 (March 29, 2016) (see generally pp 12-13 and 25).

		12 Months Ended 9/30/2016
		ROE
1	**As Reported in E.S.-1**	10.39%
2	**Adjust Equity Ratio to Last Approved**	0.06%
3	**Normalize Weather**	-0.11%
4	**Remove DSM/EE PPI Incentive**	-0.27%
5	**Remove One Time Items**	0.20%
6	**Adjust to End of Period Rate Base, incl Interest Sync**	-0.05%
7	**Annualize Depreciation Expense, incl adjusted to Depreciation Reserve**	-0.31%
8	**Adjusted ROE**	9.91%
9	**Impact of Not Approving Coal Ash Deferral**	-2.44%
10	**Adjusted ROE if Deferral Not Approved**	7.47%

DEP's authorized return on equity is 10.2%. Thus, absent approval of this request, DEP's return on equity for its North Carolina retail operations is expected to be well below the return last authorized by the Commission.

19. DEC reported returns on equity in its E.S.-1 surveillance reports of 10.33% for the 12 months ended September 30, 2016 for its North Carolina retail jurisdiction. The below table shows what these ROEs would be if adjusted for several ratemaking adjustments typically made in a general rate case. The below table also shows the effect of denying this deferral request.

		Twelve Months Ended 9/30/2016
		ROE
1	**As Reported in E.S.-1**	10.33%
2	**Adjust Equity Ratio to Last Approved**	0.40%
3	**Normalize Weather**	-0.41%
4	**Remove DSM/EE PPI Incentive**	-0.22%
5	**Remove One Time Items**	0.07%
6	**Adjust to End of Period Rate Base, incl Interest Sync**	0.04%
7	**Annualize Depreciation Expense, incl adjusted to Depreciation Reserve**	-0.13%
8	**Adjusted ROE**	10.08%
9	**Impact of Not Approving Coal Ash Deferral**	-2.47%
10	**Adjusted ROE if Deferrals Not Approved**	7.61%

DEC's authorized return on equity is 10.2%. Thus, absent approval of this request, DEC's return on equity for its North Carolina retail operations is expected to be well below the return last authorized by the by the Commission.

20. Both DEP and DEC intend to file for a general rate case in North Carolina within the next 12 months to address the prudency and ratemaking effects of the costs at issue in this Petition.

21. Approval of this deferral request will benefit the Companies and customers by helping to assure investor confidence in DEP and DEC and help assure access to needed capital on reasonable terms.

Deferral Request

22. The actual costs incurred to comply with the federal and state regulations will be deferred to a regulatory asset (Account 182.3) including a carrying charge of a

debt and equity return at the Companies' approved weighted average cost of capital, if approved by the Commission. The Companies are requesting to defer to a regulatory asset, until the effective date of new rates from the next base rate case, all non-capital costs as well as the depreciation expense and cost of capital at the weighted average cost of capital for all capital costs related to activities required under the legislative and regulatory mandates outlined in paragraphs five and seven.[6] The Companies are also requesting to defer a cost of capital on the deferred costs at the weighted average cost of capital. The Companies propose providing support for expenditures made to meet the requirements of the legislative and regulatory mandates outlined to the Commission and interested parties in retail base rate cases filed within the next twelve months.

23. Absent the deferral, the Companies may have to write off billions of dollars of costs for accounting purposes, which without question would severely impair the Companies' financial stability and ability to attract capital on reasonable terms.

24. The Companies believe that this request is consistent with the case law and policy in this State of allowing unique regulatory treatment for environmental compliance costs. For example, in Docket Nos. G-9, Sub 495 and G-21, Sub 457, the Commission authorized an ongoing deferral for compliance costs for gas pipeline integrity regulation until the next rate case, subject to a subsequent determination that the costs were prudently incurred and properly accounted for, as well as a determination as to the proper method of recovery.[7] The Commission has also authorized deferral and

[6] These amounts would include any amounts recovered pursuant to NC General Statute 62-133.2.

[7] In the Matter of Application of Piedmont Natural Gas Company, Inc. for Approval of Deferred Accounting Treatment of Interim Pipeline Integrity Management Regulation Compliance Costs, *Order Approving Deferred Accounting Treatment*, Docket Nos. G-9, Sub 495 and G-21, Sub 457 (December 2, 2004).

recovery of environmental remediation expenses. Specifically, the Commission has allowed recovery for Manufactured Gas Plant ("MGP") sites. See generally Docket Nos. G-5, Sub 327 and 495 related to environmental remediation costs incurred by the Public Service Company of North Carolina.[8] Most recently, the Commission has allowed recovery and ongoing deferral of ash basin closure costs by Dominion North Carolina Power in Docket No. E-22, Sub 532.[9]

25. As the Companies have previously committed, no fines, penalties or Dan River pipe break repair or spill cleanup costs will be included in the regulatory asset account requested in this Petition. Additionally, no fines or penalties associated with ash-related settlements reached with DENR or the EPA or any other state or federal agency will be included in such regulatory asset account.

26. The Companies request this deferral for costs incurred after January 1, 2015.

CONCLUSION

WHEREFORE, Duke Energy Progress and Duke Energy Carolinas respectfully request that the Commission allow them to establish a regulatory asset account for the deferral of all non-capital costs as well as the depreciation expense and cost of capital at the weighted average cost of capital for all capital costs related to activities required under the legislative and regulatory mandates outlined in paragraphs five and seven. The

[8] In the Matter of Application of Public Service Company of North Carolina, Inc., for an Adjustment in its Rates and Charges, *Order Granting Partial Rate Increase,* Docket No. G-5, Sub 327 (October 7, 1994); and In the Matter of Application of Public Service Company of North Carolina, Inc., for a General Increase in its Rates and Charges, *Order Approving Partial Rate Increase and Requiring Conservation Program Filing and Reporting,* Docket No. G-5, 495 (October 24, 2008)(see p. 14).

[9] In the Matter of Application of Virginia Electric & Power Company, d/b/a Dominion North Carolina Power, for Adjustment of Rates and Charges Applicable to Electric Utility Service in North Carolina, *Order Approving Rate Increase and Cost Deferrals and Revising PJM Regulatory Conditions*, Docket No. E-22, Sub 532 (December 22, 2016) (see pp 62 and 63).

Companies are also requesting to defer a cost of capital on the deferred costs at the weighted average cost of capital. The deferral would include these costs from January 1, 2015 until the approval of new rates in the Companies' next base rate cases before this Commission, to be filed within the next twelve months.

Respectfully submitted this 30th day of December, 2016.

DUKE ENERGY PROGRESS, LLC

DUKE ENERGY CAROLINAS, LLC

BY: Heather Shirley Smith

Heather Shirley Smith
Deputy General Counsel
Duke Energy Corporation
40 W. Broad St., Suite 690
Greenville, South Carolina 29601

Lawrence B. Somers
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410 S. Wilmington Street, NCRH 20
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I/A

ATTACHMENT 1

DUKE ENERGY.

Brian D. Savoy
SVP, Chief Accounting Officer and Controller
550 South Tryon Street
Mail Code: DEC 44-A
Charlotte, NC 28202
o 704-382-6242
f 980-373-6797

December 21, 2015

Ms. Gail L. Mount
Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4325

RE: Explanation of Accounting Treatment Related to Coal Ash Basin Obligations

Dear Ms. Mount:

Duke Energy Progress, LLC ("DEP") and Duke Energy Carolinas, LLC ("DEC") (collectively, the "Companies") respectfully notify the Commission of certain accounting entries, which are consistent with Generally Accepted Accounting Principles ("GAAP"), Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts and General Instruction No. 25, and regulatory accounting practices related to the establishment of certain Asset Retirement Obligations ("AROs") associated with federal and state requirements related to coal ash management and ash basin closure costs. The Companies also notify the Commission of their treatment of actual expenditures related to compliance with such federal and state requirements, and the establishment of a regulatory asset for such expenditures.

Description of Requirements Giving Rise to the AROs

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification for Asset Retirement and Environmental Obligations ("ASC 410-20")

and FERC General Instruction No. 25, each of the Companies records an ARO when it has a legal obligation to incur retirement costs associated with the retirement of a long-lived asset and the obligation can be reasonably estimated. These accounting requirements dictate the measurement and recognition of AROs for companies in general. The Commission has issued orders allowing the Companies to defer all impacts of establishing an ARO until these costs can be considered in future rate making decisions.[1] In addition, DEP's rates currently include a component for ash remediation costs as a part of Cost of Removal included in depreciation rates; however, only a small balance has been collected for such costs since DEP's last retail rate case in North Carolina.

In April 2015, the Environmental Protection Agency ("EPA") published in the Federal Register a rule to regulate the disposal of Coal Combustion Residuals ("CCRs") from electric utilities as solid waste.[2] The federal regulation classifies CCR as nonhazardous waste under Subtitle D of the Resource Conservation and Recovery Act and allows beneficial use of CCRs with some restrictions. The federal regulation applies to all new and existing landfills, new and existing surface impoundments, structural fills and CCR piles. The federal regulation establishes requirements regarding landfill design, structural integrity design and assessment criteria for surface impoundments, groundwater monitoring and protection procedures and other operational and reporting procedures to ensure the safe disposal and management of CCR. In addition to the

[1] *In the Matter of Duke Power's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account*, NCUC Docket No. E-7, Sub 723, *Order Granting Motion for Reconsideration and Allowing Deferral of Costs* (August 8, 2003); and *In the Matter of Carolina Power & Light Company's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account*, NCUC Docket No. E-2, Sub 826, *Order Granting Motion for Reconsideration and Allowing Deferral of Costs* (August 12, 2003).

[2] Hazardous and Solid Waste Management system: Disposal of Coal Combustion Residuals from Electric Utilities promulgated by the United States Environmental Protection Agency ("EPA") and published on April 17, 2015, 80 Fed Reg. 21302 ("CCR rule").

requirements of the federal CCR regulation, CCR landfills and surface impoundments will continue to be independently regulated by most states, including North Carolina.

In September 2014, the North Carolina Coal Ash Management Act (the "Coal Ash Act") 2014 N.C. Sess. Laws 122; 2014 N.C. Ch. 122; 2013 N.C. SB 729, became law and was amended in June 2015, by the Mountain Energy Act. The Coal Ash Act, as amended,

(i) establishes a Coal Ash Management Commission ("Coal Ash Commission")[3] to oversee handling of coal ash within the state;

(ii) prohibits construction of new and expansion of existing ash impoundments and use of existing impoundments at retired facilities;

(iii) requires closure of ash impoundments at DEP's Sutton Plant and DEC's Riverbend and Dan River stations no later than August 1, 2019 and DEP's Asheville Plant no later than August 1, 2022;

(iv) requires dry disposal of fly ash at active plants, excluding the Asheville Plant, not retired by December 31, 2018;

(v) requires dry disposal of bottom ash at active plants, excluding the Asheville Plant, by December 31, 2019, or retirement of active plants;

(vi) requires all remaining ash impoundments in North Carolina to be categorized as high-risk, intermediate-risk or low-risk no later than December 31, 2015 by the North Carolina Department of Environment Quality ("DEQ," formally known as the NC Department of Environmental and Natural Resources, or "DENR") with the method of closure and timing to be based upon the assigned risk, with closure no later than December 31, 2029;

(vii) establishes requirements to deal with groundwater and surface water impacts from impoundments; and

(viii) enhances the level of regulation for structural fills utilizing coal ash.

[3] The structure of the Coal Ash Commission has been challenged as a violation of the constitutional separation of powers between the Executive Branch and the General Assembly. A decision by the N.C. Supreme Court is pending. Depending on the result, the decision could place doubt on previous actions by the Coal Ash Commission.

The Coal Ash Act includes a variance procedure for compliance deadlines and modification of requirements regarding structural fills and compliance boundaries. The Companies have and will periodically submit to DEQ site-specific coal ash impoundment closure plans or excavation plans in advance of closure. These plans and all associated permits must be approved by DEQ before any excavation or closure work can begin.

In 2014 and 2015, DEC executed consent agreements with the South Carolina Department of Health and Environmental Control ("SCDHEC") and conservation groups requiring the excavation of an inactive ash basin and ash fill area at the W.S. Lee Steam Station. In July 2015, DEP executed a consent agreement with the SCDHEC requiring the excavation of an inactive ash fill area at the Robinson Plant within eight years. The W.S. Lee Station site and the Robinson Plant are required to be closed pursuant to the recently issued federal CCR rule and/or the provisions of these consent agreements which are consistent with the federal CCR closure requirements described above.

Accounting for Coal Ash Basin AROs

AROs are legal obligations associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and (or) the normal operation of a long-lived asset and also include environmental remediation liabilities that result from the normal operation of a long-lived asset and that is associated with the retirement of that asset. AROs recorded on the DEC and DEP Balance Sheets at November 30, 2015 are based upon the legal obligation for closure of coal ash basins and the disposal of related ash as a result of the federal and state requirements described above, and total approximately $1.84 billion for DEC and approximately $2.13 billion for DEP. These AROs are included in the Companies' financials as allowed by NCUC Docket No. E-7, Sub 723, Order dated August 8, 2003 and

NCUC Docket No. E-2, Sub 826, Order dated August 12, 2003. The actual compliance costs incurred may be materially different from these estimates based on the timing and requirements of the final regulations.

Liabilities Recorded Related to the AROs

The Companies measure and recognize AROs in accordance with ASC 410-20 (previously Statement of Financial Accounting Standards "SFAS" No. 143). ASC 410-20 requires that the fair value of a liability for an ARO be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. As such, the coal ash ARO liability balance as of November 30, 2015 is based on the initial liability recognized in September 2014 upon the passage of the Coal Ash Act, as adjusted for accretion expense (discussed further below), cash settlements, and remeasurements of the liability. Remeasurements to the liability are due to revisions in either the timing or the amount of the original estimate of undiscounted cash flows. Typically, remeasurements occur when there are significant new events and information (e.g., passage of the federal CCR regulation, changes to closure plans, etc.) used by management in the estimation of future expected cash outflows.

The ARO was initially calculated, along with subsequent remeasurements and additions to the liability, using an expected present value technique of probability weighted discounted cash flows. These cash flows were based on management's best estimate of projected cash flows and legal interpretation of the various federal and state requirements described above. As the obligations can be satisfied by various compliance alternatives selected based on management's site-specific risk assessments over various timeframes, the uncertainty surrounding the obligations was factored into the ARO recognition by assessing the likelihood (probability) that a certain type of compliance method would be required.

These estimated cash flows, along with various other financial assumptions required by ASC 410-20 (including inflation and discount rates, profit margin and risk premium) were used to properly measure the AROs on the balance sheet at fair value, as defined by GAAP.

Because the liability is based on a present value calculation using many assumptions, including a credit-adjusted risk-free discount rate, the liability will grow simply from the passage of time. This increase to the liability is known as accretion. From January 1, 2015 to November 30, 2015, accretion totaled $59 million and $65 million for DEC and DEP, respectively.

Assets Associated with the Liability Recorded Related to the AROs

At the time the ARO liability is recorded, a corresponding and equivalent ARO asset is recorded on the books, as part of the cost of the associated coal plant in the property, plant and equipment ("PP&E") accounts, or if associated with a retired coal plant, recorded in regulatory assets. The ARO PP&E balance is depreciated over the remaining estimated plant lives, and such depreciation expenses is deferred into regulatory asset accounts. From January 1, 2015 to November 30, 2015, ARO depreciation totaled $217 million and $325 million for DEC and DEP, respectively. Additionally, as discussed above, accretion is added to the ARO liability each reporting period to account for the time value of money, so that at the time of retirement, the recorded ARO liability will be sufficient to provide for the cash outlays necessary to meet the legal obligation. Thus, the ARO expense recorded each year generally includes two components: depreciation expense associated with the ARO asset on active plants and accretion expense measuring the change in the total ARO liability due to the time value of money. Consistent with the requirements of the Commission's Order dated August 8, 2003 in Docket No. E-7, Sub 723 and Order dated August 12, 2003 in Docket No. E-2, Sub 826, all income statement impacts related to AROs ultimately reside in regulatory asset accounts.

The FASB recognized that differences may exist between the requirements of ASC 410-20 and the treatment of ARO cost for regulatory purposes, and accordingly, provided that a regulated entity subject to ASC 980, *Regulated Operations*, (formerly SFAS 71, *Accounting for the Effects of Certain Types of Regulation*), could recognize a regulatory asset or liability for any differences between the two approaches, if the facts and circumstances meet the requirements of ASC 980 for such recognition.

Net Asset Balance Primarily Relates to Cash Expenditures

As of November 30, 2015, PP&E (active plants) and regulatory assets (inactive plants) related to coal ash basin AROs total approximately $4.19 billion, combined for both categories of assets and DEC and DEP. The related asset retirement obligation liabilities total approximately $3.97 billion, resulting in a net asset balance of approximately $220.5 million. Of this amount, $231.9 million relates to cash expenditures incurred in 2015 associated with ash basin closure, and $2.7 million relates to carrying costs, partially offset primarily by recoveries through existing DEP cost of removal rates.

As a result of the deferral accounting applied to this ARO liability, actual costs incurred to comply with the federal and state regulations regarding closure of ash basins are being deferred. As coal ash basin closure compliance costs are incurred, the Companies are reducing the ARO liability and the associated ARO regulatory asset described above, while simultaneously creating a corresponding separate regulatory asset that represents actual cash expenditures incurred. As the Companies are excluding all associated coal ash ARO deferrals for earnings surveillance reporting and are funding these expenditures with its debt and equity capitalization, the Companies are recording a debt and equity return ("carrying charge") on the aforementioned net asset for regulatory purposes. GAAP requires the equity return to be

deferred (i.e., not recognized) until rate recovery has begun, and thus the only carrying charge recorded to date for GAAP purposes is the debt return, which totals approximately $2.7 million combined for the Companies through November 30, 2015. Ultimately, only actual costs resulting in cash outlays by the Companies related to ash basin closure, plus carrying charges, will result in amounts for which the Companies will request accounting and recovery treatment in future filings before this Commission. Coal ash basin costs that relate to activities outside the scope of the aforementioned legally required activities (e.g., Federal CCR rules and the NC CAMA legislation) are being expensed immediately as Operations and Maintenance ("O&M") expense. In addition, capital conversion costs such as those related to conversion to dry or fly ash equipment are recorded in Construction Work in Progress.

The Companies do not seek any further specific accounting approval at present due to the uncertainties in North Carolina regarding the closure costs of coal ash basins. Actual costs to be incurred will be dependent upon factors that vary from site to site. The most significant factors are the method and time frame of closure at the individual sites. Closure methods considered include removing the water from the basins and capping the ash with a synthetic barrier, excavating and relocating the ash to a lined structural fill or lined landfill, or recycling the ash for concrete or some other beneficial use. Under the previously cited Coal Ash Act, DEQ is required to prioritize sites by December 31, 2015. That process has not been completed. Once the DEQ determinations are made, the Companies will need to evaluate the recommendation and develop more specific cost estimates. The ultimate method and timetable for closure will be in compliance with standards set by the EPA rule and any state regulations. The ARO estimates will be adjusted as additional information is gained through the closure process, including acceptance and approval of compliance approaches which may change management

assumptions, and may result in a material change to the recorded ARO. In addition, on March 5, 2015, Governor McCrory filed a lawsuit challenging the constitutionality of the Coal Ash Commission. That case is currently pending before the North Carolina Supreme Court.[4] Pending a decision in that case, activity by the Coal Ash Commission has been suspended. Further, if the Court should rule that the actual structure of the Coal Ash Commission violates the constitutional provision of the separation of powers, the lawfulness of previous actions by the Commission could be subject to legal challenge.

The Companies provide this explanation of their accounting for the above-described ash basin closure and compliance costs for the Commission's information at this time. At a later date, when there is sufficient clarity in North Carolina regarding the closure of ash basins, the Companies will bring this matter before the Commission for ultimate disposition.

If you have any questions, please let me know.

Sincerely,

Brian D. Savoy
Senior Vice President, Chief Accounting Officer and Controller

cc: Antoinette R. Wike
Christopher J. Ayers
Chairman Edward S. Finley, Jr
Commissioner Don M. Bailey
Commissioner Bryan E. Beatty
Commissioner ToNola D. Brown-Bland
Commissioner Jerry C. Dockham
Commissioner James G. Patterson
Commissioner Susan Warren Rabon

[4] *Patrick L. McCrory, et al v. Phillip E. Berer, et al. NC Supreme Court*, Case No. 113A15 (2015).

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 723

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Duke Power's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account	)))))	ORDER GRANTING MOTION FOR RECONSIDERATION AND ALLOWING DEFERRAL OF COSTS

BY THE COMMISSION: On May 20, 2003, Duke Power, a Division of Duke Energy Corporation (Duke or Company), filed a motion requesting that the Commission reconsider that portion of its Order issued April 4, 2003, in the above-referenced docket, which denied Duke's request to defer the forward-requirements impact of the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143) and, instead, grant such request.

BACKGROUND

Duke's initial petition was filed on January 10, 2003. It concerned a request for authority to place certain Asset Retirement Obligation (ARO) costs in deferred accounts. Duke stated that such authority was needed so that its financial statements will continue to reflect the current regulatory treatment for these costs and will not be altered due to Duke's adoption of SFAS 143.

As explained by Duke in its initial petition, in June 2001, the FASB issued SFAS 143, effective for fiscal years beginning after June 15, 2002. SFAS 143, which must be implemented by Duke in order to comply with generally accepted accounting principles (GAAP), mandates a new method for measuring and accounting for certain AROs. Those obligations, as defined by SFAS 143, concern legal obligations associated with the retirement of tangible, long-lived assets. Duke indicated that it expected that the only significant retirement costs constituting AROs subject to SFAS 143 would be its obligations to decommission the radiated portions of its nuclear plants and environmental clean-up at its Belews Creek Coal-fired Steam Plant; although according to Duke, other AROs may exist.

If a legally enforceable ARO, as defined by SFAS 143, is deemed to exist for a firm, a liability for the ARO must be measured and recorded on the firm's books in the period in which it is incurred. The liability must be recorded at fair value, that is, the

amount that the firm would pay in the market to settle the liability. If market prices are not available, estimates of fair value can be calculated by discounting the estimated cash flows associated with the ARO to their present value at the date the liability is to be recorded.

At the time the liability is recorded, a corresponding and equivalent ARO asset is recorded on the firm's books, as part of the cost of the associated tangible asset. The ARO asset is depreciated over the life of the associated long-lived asset. Additionally, an accretion is added to the ARO liability each reporting period to account for the time value of money, so that at the time of retirement the recorded ARO liability will be sufficient to provide for the cash outlays necessary to meet the legal obligation. Thus, the ARO expense recorded each year during the life of the tangible asset generally includes two components: depreciation expense associated with the ARO asset and accretion expense measuring the change in the ARO liability due to the time value of money. The ARO liability and associated ARO asset may also change over time due to revisions in the timing or the amount of the original estimate of ARO costs. Such changes can affect the recorded expense in the period of change and/or future periods.

In addition to the forward-looking requirements of SFAS 143 described above, firms are also required to recognize the cumulative impact in the financial statements in the year of its implementation. This cumulative impact amounts to a "catch-up" entry on the firm's books, so that in future years the financial statements will appear as if the requirements of SFAS 143 had always been followed.

The FASB recognized that differences may exist between the requirements of SFAS 143 and the treatment of ARO costs for regulatory purposes, and accordingly, provided that a regulated entity subject to Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS 71), could recognize a regulatory asset or liability for any differences between the two approaches, if the facts and circumstances meet the requirements of SFAS 71 for such recognition.

In its initial Petition, Duke requested that the Commission authorize it to place all income statement impacts arising from the Company's adoption of Statement 143 in regulatory deferred accounts. The amounts proposed to be deferred included both the net cumulative/catch-up and the forward-requirements impacts.

By Order issued April 4, 2003, the Commission granted the Company's request to defer the cumulative impact of SFAS 143, subject to certain conditions. However, Duke's request to defer the forward-requirements impact of SFAS 143 was denied.

In denying the request to defer the forward-requirements impact, the Commission stated that "[i]t simply cannot be determined from the record that the forward-requirements represent major expenditures or that they otherwise satisfy a condition of the Clean Smokestacks Bill [Bill] such that the Commission would have the authority to allow def`rral of those costs as an exception to the rate freeze." The Bill, in particular G.S. 62-133.6(e), provides that, during the period of the rate freeze,

June 20, 2002, through December 31, 2007, the Commission may allow the deferral of costs or revenues by a utility if the utility experiences "governmental action resulting in significant cost reductions or requiring major expenditures including but not limited to the cost of compliance with any law, regulation, or rule for the protection of the environment or public health, other than environmental compliance costs."

MOTION FOR RECONSIDERATION

In its motion for reconsideration, Duke stated that the requirements of SFAS 143 do not only include Duke's reflection of a cumulative amount on its income statement as an expense in the year of implementation of SFAS 143, but also an ongoing obligation to reflect all ongoing differences between ARO expenses recorded as required under SFAS 143 and those recorded as determined under the Commission's historical method. Duke, after having opined that SFAS 143 constituted a single "governmental action," submitted that the Commission should have viewed the impacts of the cumulative requirement and the forward-requirements in totality rather than individually, as it did in reaching its conclusion that Duke's request regarding the forward-requirements impact should be denied.

Duke stated that, if the cumulative requirement is "undoubtedly" a major expenditure, as the Commission found in the Order, then it follows that the forward-requirements impact only enhances the magnitude of the impact of the cumulative requirement. Therefore, according to Duke, regardless of the magnitude of the resulting expenditures of the forward-requirements, their deferral is appropriate under the Bill. Thus, according to Duke, it is unnecessary for the Commission to determine whether the forward-requirements impact viewed in isolation, represents major expenditures or otherwise satisfies a condition of the Bill, such that the Commission would have the authority to allow deferral of those costs as an exception to the rate freeze.

Duke noted that the Commission correctly found in the Order that:

> Not only should Duke's rates reflect the Commission's decisions . . . its financial statements, including reports to this Commission, should also clearly reflect and adequately disclose the economic consequences of the Commission's actions. If the present deferral request is not allowed, the FASB will have, effectively, usurped the Commission's authority in regard to the establishment of the appropriate level of ARO costs properly includable as an operating revenue deduction for financial reporting purposes with respect to the Company's North Carolina retail operations. That result, however, is avoided to the maximum extent possible as a result of the Commission having approved deferral of the cumulative impact of SFAS 143. That result is, unmistakably, appropriate. *The foregoing reasoning, of course, applies equally to that part of the petition which the Commission has denied, i.e., the Company's request for*

deferral of the forward-requirements of SFAS 143. (Emphasis added in original.)

Duke argued that, for the reasons stated above and based on the Commission's own findings as quoted above, it is inappropriate to view the forward-requirements impact of SFAS 143 in isolation in evaluating whether Duke's request meets the elements of the deferral provisions of the Bill. Nevertheless, Duke averred that the magnitude of the amounts contained in the confidential information provided as Attachment A to its motion for reconsideration supports approval of Duke's deferral of the forward-requirements impact of SFAS 143. Attachment A, which was filed under confidential seal, presents a calculation of the differences between decommissioning costs under SFAS 143 and such costs determined in accordance with the Commission's past decisions for the five-year period ending December 31, 2007.

Duke stated that the impacts of the forward-requirements are likely to fluctuate over time because they are dependent on, among other things, the earnings of Duke's nuclear decommissioning funds and the amount of accretion expense. Duke noted that the funds earnings rates used in the calculation of the differences described above - i.e., in the calculation of the estimated deferral amounts – assumes the funds' annual earnings will equal the annual averages of the last five years of Duke's actual funds earnings rates.

Finally, Duke commented that, in addition to the impact of prospectively changing to SFAS 143 for the legal asset retirement obligations, disallowance of deferral accounting for the forward-requirements impact may result in accounting changes for nonlegal asset retirement obligations that are currently being accounted for through Commission approved depreciation rates. Examples of nonlegal asset retirement obligations are the costs of removal of distribution, transmission, and nonnuclear generation facilities. Duke stated that it does not believe that the Commission intended to modify current depreciation rates or the accounting for cost of removal in the Order and respectfully requested the Commission to clarify that it did not intend to modify Duke's current depreciation rates or the accounting for cost of removal for nonlegal obligations.

In summary, Duke requested that the Commission reconsider its April 4, 2003 Order denying the Company's request to defer the forward-requirements impact of SFAS 143 and, on consideration of the additional information provided, allow the deferral of that impact. Duke also requested that the Commission clarify that no modification of Duke's current depreciation rates or accounting for cost of removal was intended by the Order.

COMMENTS

On May 27, 2003, the Commission issued an Order requesting comments on Duke's motion for reconsideration. On June 6, 2003, Carolina Utility Customers

Association, Inc. (CUCA), Attorney General Roy Cooper (Attorney General), and the Public Staff – North Carolina Utilities Commission (Public Staff) filed comments.

CUCA, in its comments, opposed the deferral of the forward-requirements impact of SFAS 143 and asked the Commission to deny Duke's motion for reconsideration. CUCA opined that a "mere expectation or estimate by Duke of a potential impact does not rise to the level of a governmental action requiring major expenditures." CUCA further averred that, until a significant cost reduction is realized or a major expenditure is required, deferral is neither appropriate nor lawful.

Additionally, CUCA opined that, if Duke seeks to defer annual estimated costs, perhaps the time has come to initiate a proceeding to estimate and then defer any expected savings and revenue windfalls Duke may enjoy as a result of governmental action during the rate freeze period, including but not limited to tax legislation.

The Attorney General commented that Duke's motion for reconsideration should be denied because it does not present sufficient new information to justify reconsideration. The Attorney General stated that the Commission had properly considered the cumulative and forward-requirements impact of SFAS 143.

The Attorney General commented that SFAS 143 was adopted in 2001. The Attorney General stated that, in addition to requiring new ARO expense guidelines for Duke's financial reporting from January 1, 2003, forward, it also required Duke to make adjustments to its ARO expenses back to day one of each nuclear plant's service. Thus, according to the Attorney General, there is a logical division between applications of the new rule based first on its present cumulative effect and second on its forward effect. Additionally, according to the Attorney General, there is greater uncertainty associated with projections of the costs to be deferred related to the forward-requirements impact than there is with respect to the determination of costs to be deferred related to the cumulative impact. The Attorney General averred that, unless Duke provides the Commission with a reliable projection of its decommissioning receipts and earnings for 2003 forward, it will be impossible for the Commission to fashion relief that maintains the status quo in consideration of the forward-requirements of SFAS 143.

The Attorney General argued that:

> The Commission's decision to make a separate determination of deferred costs for SFAS 143's cumulative and forward-requirements effects was well founded. In addition, based on its expertise in such matters, the Commission is afforded wide discretion in assessing the facts and making this policy judgment. *See State ex rel. Utils. Comm'n v. North Carolina Textile Mfrs. Ass'n,* 59 N.C. App. 240, 245, 296 S.E.2d 487, 492 (1982), rev'd on other grounds, 309 N.C. 238, 306 S.E.2d 113 (1983).

The Attorney General commented that, in its motion, Duke asked the Commission to approve the deferral of that portion of the SFAS 143 expenses which exceed the projected receipts and earnings of Duke's decommissioning fund. The Attorney General noted that the main expense under SFAS 143 will be the annual increase in the present value of the projected amount required for decommissioning. According to the Attorney General, that increase in present value is based on a discount rate, an annual percentage that reflects the estimated increase in the cost of retiring the asset as the retirement date gets closer.

The Attorney General stated that Duke's Attachment A is a comparison of projected ARO cost under SFAS 143 with projected receipts and earnings under Duke's present method of recovering decommissioning costs. The Attorney General noted that, in Attachment A, Duke does not state the length of plant service nor the discount rate applied in computing the projected ARO costs from 2003 through 2007. The Attorney General further stated that, however, Duke's estimate of earnings on its decommissioning receipts is based on actual earnings during the period 1998 through 2002.

The Attorney General argued that, in order to accurately compare SFAS 143 expenses to decommissioning receipts, the methodology of computing those two numbers should be consistent. The Attorney General stated that the annual SFAS 143 expense is based on a cost estimate, applying an appropriate discount rate over an extended time period. Similarly, according to the Attorney General, the annual trust receipts to which the expense is being compared should be based on a value estimate, applying an appropriate rate of return over the same extended time period. The Attorney General averred that Duke's Attachment A does not provide the Commission with sufficient information to determine whether Duke's methodology for comparing projected expenses and receipts is reliable.

The Attorney General stated that Duke's Attachment A does not answer the Commission's main question about deferral of SFAS 143's forward-requirements - whether SFAS 143 creates the need for major expenditures from 2003 forward. Therefore, the Attorney General argued that the Commission should not accept Duke's Attachment A as a basis for modifying the Commission's original Order. In concluding, the Attorney General moved that the Commission deny Duke's motion for reconsideration, due to the inadequacy of the additional information presented by the Company.

In its comments, the Public Staff supported Duke's request. The Public Staff restated its view, as previously stated in its initial comments, that deferral of the cumulative impact as well as the forward-requirements impact would preserve the historical and current Commission treatment of such costs for current regulatory purposes.

The Public Staff further opined that the cumulative and forward-requirements impacts of SFAS 143 are matters that are closely related and as such should be

considered collectively and not separately. The Public Staff argued that the ultimate ARO liability is unaffected by the adoption of SFAS 143 and that the interim expense increases – or deferred costs – arising from its adoption will eventually be offset by expense decreases – or deferred credits - which, ultimately, will be incorporated into the forward-requirements impact. Therefore, according to the Public Staff, deferral of the forward-requirements impact will, in effect, itself function to "amortize" the deferred cumulative impact of SFAS 143. Also, the Public Staff stated that, if the Commission does not approve the deferral of the forward-requirements impact, it will be unresolved as to how the deferred cumulative impact will be amortized.

Additionally, the Public Staff recommended that the Commission confirm that it did not intend to modify the prospective accounting for cost of removal obligations associated with assets that are not legal AROs. As the Public Staff noted, historically, cost of removal has been a component of Duke's depreciation rates as approved by this Commission. Consequently, such costs are being accrued and recognized as operating revenue deductions over the life of the related assets, rather than being charged to expense when actually paid. It is the Public Staff's position that any changes in the regulatory accounting for cost of plant removal should be considered in a general rate case or other appropriate proceeding.

CONCLUSIONS

For reasons discussed below, the Commission is of the opinion that good cause exists to grant Duke's motion for reconsideration and approve its request to defer the forward-requirements impact of SFAS 143.

As noted above, the Commission in its Order of April 4, 2003, denied the Company's initial request for deferral of the forward-requirements impact of SFAS 143. In so doing, the Commission stated that "[i]t simply cannot be determined from the record, as it presently exists, that the forward-requirements represent major expenditures or that they otherwise satisfy a condition of the Clean Smokestacks Bill [Bill] such that the Commission would have the authority to allow deferral of those costs as an exception to the rate freeze." The Bill, in particular G.S. 62-133.6(e), provides that during the rate freeze period, which began with the effective date of this provision of the Bill - June 20, 2002 - and ends December 31, 2007, the Commission may allow the deferral of costs or revenues by a utility if the utility experiences "governmental action resulting in significant cost reductions or requiring major expenditures including but not limited to the cost of compliance with any law, regulation, or rule for the protection of the environment or public health, other than environmental compliance costs."

As previously discussed, Duke takes the position that SFAS 143 constituted a single "governmental action." Accordingly, the Company argued that the Commission should have viewed the impacts of the cumulative requirement and the forward-requirements in totality rather than individually. Duke indicated that under that scenario it logically followed that the forward-requirements impact would have met the

deferral provisions of the Bill, since they would have served to enhance the magnitude of the cumulative impact. The Order allowed deferral of the cumulative impact of SFAS 143 because it was found to be a major expenditure as contemplated by the Bill.

The Public Staff also argued that the cumulative and forward-requirements of SFAS 143 should be considered collectively and not separately. The Public Staff stated that those impacts are closely related and that the forward-requirements impact would, effectively, operate to "amortize" the deferred cumulative impact of SFAS 143.

The Attorney General stated that the Commission's decision to make a separate determination of deferred costs for SFAS 143's cumulative and forward-requirements effects was well founded. The Attorney General argued that there is a logical division between applications of the new rule based first on its present cumulative effect and second on its forward effect.

The Commission agrees with the Attorney General that the present impacts should be considered separately, rather than collectively. While it may be reasonable to view the implementation of SFAS 143 as a single "governmental action" for the present purpose, its provisions clearly require the recognition of two different major categories of costs, cumulative costs and forward-requirements costs. Accordingly, the Commission is of the opinion, and so concludes, that the present arguments of the Company and the Public Staff are without merit.

Attachment A to the Company's motion is a schedule which presents, among other things, a calculation of the annual forward-requirements impact for each fiscal year during the five-year rate freeze period ending December 31, 2007, i.e., 2003 through 2007. That calculation includes partial offsets to depreciation and accretion expenses. Those offsets represent the levels of earnings expected to be realized on the decommissioning trust funds during the present five-year period. They are based on projected earnings rates which represent the Company's actual experience during the previous five-year period ended December 31, 2002, with respect to its nuclear decommissioning qualified and nonqualified trusts. Such rates appear to be significantly lower than the discount rate used by the Company to determine the present value of its nuclear decommissioning ARO. As pointed out by the Attorney General, such discount rate was not provided to the record. However, given the low levels of the projected earnings rates, it is entirely reasonable to infer that those rates are well below the discount rate.

The Commission agrees with the Attorney General that the computations should employ an appropriate discount rate and appropriate trust funds earnings rates. However, based on the position taken by the Attorney General in another docket (Docket No. E-2, Sub 826, Carolina Power & Light Company's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account), it would appear that the crux of the issue here is whether the discount rate and the trust funds' earnings rates should be the same, as well as the time periods. Sameness in those regards was the position taken by the Attorney General in Docket No. E-2, Sub 826.

The Commission disagrees with the Attorney General that the discount rate, the trust funds' earnings rates, and the time periods must be the same for the present purpose. As the Commission understands it, absent a Commission Order to the contrary, under SFAS 143, for both accounting and reporting purposes, the Company is required to recognize, on a current basis, the earnings actually realized on the trust funds. Indeed, one of the major, if not the major, differences between the periodic levels of decommissioning costs determined under the Commission's historical approach and that determined under SFAS 143 arises from the fact that the former approach is based on a levelized or uniform earnings rate over the service lives of the nuclear plants through decommissioning, whereas the latter methodology, effectively, produces variable rates. That results because the rates, in part, are functions of periodic earnings actually realized on the trust funds, which vary over time. As indicated, that is not the case with the Commission's historical approach.

Accordingly, the Commission is of the opinion, and so concludes, that, for the present purpose, it is entirely appropriate, in estimating the forward-requirements impact of SFAS 143, to use the levels of earnings the Company can reasonably be expected to achieve during the period 2003 through 2007. Further, based on the information of record, the Commission is of the opinion, and so concludes, that the estimated earnings rates employed by Duke in determining the annual levels of earnings it expects to actually realize on the trust funds during the aforesaid period are reasonable.

As previously stated, CUCA opined that a "mere expectation or estimate by Duke of a potential impact does not rise to the level of a governmental action requiring major expenditures." CUCA further averred that, until a significant cost reduction is realized or a major expenditure is required, deferral is neither appropriate nor lawful.

The Commission disagrees with CUCA. Duke's implementation of SFAS 143 with respect to the forward-requirements impact, which would be mandatory under GAAP, absent an Order from the Commission to the contrary, would require the Company to record the forward-requirements impact as an item of expense in its books, and reflect the effect of such expense in its financial reports, when incurred. Under SFAS 143, such costs are considered to be incurred by Duke beginning on January 1, 2003, notwithstanding the fact that the accrual of same requires the use of estimates. Clearly, the use of reasonable and appropriate estimates as well as reasonable and appropriate assumptions and judgment is inherent in the application of GAAP.

Whether the costs in question were precipitated by a governmental action does not appear to be in dispute. In any event, that matter was addressed by the Commission in its Order issued on April 4, 2003, in this docket, and need not be revisited here. Suffice it to say that the Commission has previously concluded that the required implementation of SFAS 143 is, effectively, a governmental action.

CUCA also commented that, if Duke seeks to defer annual estimated costs, perhaps the time has come to initiate a proceeding to estimate and then defer any expected savings and revenue windfall Duke may enjoy as a result of governmental action during the rate freeze period, including but not limited to tax legislation. However, CUCA did not point to any specific governmental action that might warrant the action suggested. Therefore, due to lack of specificity, the Commission is of the opinion, and so concludes, that CUCA's argument is without merit.

Regarding whether the present costs constitute a major expenditure as envisioned by the Bill, the Commission is of the opinion, and so concludes, that they do. In Attachment A to Duke's motion for reconsideration, the Company estimated the extent to which its total company forward-requirements costs under SFAS 143 will exceed the levels of costs currently projected. For the period 2003 through 2007, such costs, as shown in Attachment A, in the aggregate clearly constitute a major expenditure. Thus, based on that consideration and all other information of record, the Commission concludes that the forward-requirements costs collectively constitute a major expenditure as contemplated by the Bill.

Therefore, having concluded (1) that the estimated earnings rates employed by Duke in determining the annual levels of earnings it expects to actually realize on the nuclear decommissioning trust funds during the aforesaid period are reasonable and appropriate for use in the present regard, (2) that the forward-requirements costs will, in fact, be incurred and recorded as an item of expense in Duke's books, absent deferral, and (3) that the imposition of such costs results from governmental action and, absent deferral, would collectively constitute a major expenditure under the Bill, and in consideration of (4) the Public Staff's position that Duke's requests should be approved and (5) all other information of record, the Commission is of the opinion, and so concludes, that it should reconsider that portion of the Order issued April 4, 2003, in this docket, which denied Duke's request to defer the forward-requirements impact of SFAS 143 and, instead, grant such request.

There is one final matter that needs to be addressed. As previously mentioned, Duke commented that disallowance of deferral accounting for the forward-requirements impact of SFAS 143 may result in accounting changes for nonlegal asset retirement obligations that are currently being accounted for through Commission-approved depreciation rates.

The Public Staff also observed that, historically, cost of removal has been a component of Duke's depreciation rates as approved by this Commission. And, as noted above, the Public Staff recommended that the Commission confirm that it did not intend to modify the prospective accounting for cost of removal obligations associated with assets that are not legal AROs.

Depreciation expense, which in part is a function of depreciation rates, was included as a component of the Company's North Carolina retail (N.C. retail) cost of service established in the context of the Company's last general rate case proceeding.

Consequently, the recovery of that expense, which includes the cost of removal, is now provided for in the rates and charges Duke is authorized to charge for its sales of service with respect to its N.C. retail operations. Consistent with the economic consequences of that regulatory treatment, the cost of removal is accrued and recognized as an operating revenue deduction over the useful life of the related assets, rather than waiting to record the expense until the assets are actually removed and the related costs actually paid. It is the Public Staff's position that any changes in accounting for those costs should be considered in a general rate case or other appropriate proceeding.

In consideration of the fact that recovery of the cost of removal in question has been and is now provided for in the Company's rates, as approved in the context of its last general rate case proceeding as well as other past proceedings, and in consideration of the magnitude of such costs, the Commission is of the opinion, and so concludes, that, as suggested by the Public Staff, it is entirely appropriate, to avoid any misconstruction, for the Commission to confirm that it did not intend to, and did not, prospectively or otherwise, modify the regulatory treatment previously adopted for the cost of removal as provided for most recently in the context of the Company's last general rate case proceeding. Additionally, the Commission is of the opinion, and so concludes, that the Company should be, and hereby is, explicitly placed on notice that any proposed changes in the cost of removal for long-lived assets and/or in the accounting for such costs must be submitted to the Commission for its approval in the context of a general rate case or other appropriate proceeding prior to implementation.

IT IS, THEREFORE, ORDERED as follows:

1. That Duke's motion requesting that the Commission reconsider that portion of its Order issued April 4, 2003, in this docket, which denied the Company's request to defer the forward-requirements impact of the FASB's SFAS 143, shall be, and hereby is, allowed.

2. That, on reconsideration, Duke's request to defer the forward-requirements impact of SFAS 143 shall be, and hereby is, approved subject to the following conditions, to the end that Duke's adoption of SFAS 143 shall, in effect, have no impact, currently or prospectively, on the Company's North Carolina retail operations, pending further order of the Commission:

a. That the intent and outcome of the deferral process shall be to continue the Commission's currently existing accounting and ratemaking practices for nuclear decommissioning costs and other ARO costs.

b. That the adoption of SFAS 143 shall have no impact on Duke's operating results or return on rate base for North Carolina retail regulatory purposes and that the net effect of the deferral accounting allowed shall be to reset Duke's North Carolina retail rate base, net

operating income, and regulatory return on common equity to the same levels as would have existed had SFAS 143 not been implemented.

c. That the implementation of SFAS 143 for financial reporting purposes and the deferrals allowed in this docket shall have no impact on the ultimate amount of costs recovered from the North Carolina retail ratepayers for nuclear decommissioning or other AROs, subject to future orders of the Commission.

d. That the individual line items and account balances in the quarterly ES-1 surveillance filings and the annual cost of service studies filed by Duke with the Commission shall be stated as if SFAS 143 had not been implemented by Duke.

e. That when Duke files its annual report required by Commission Rule R1-32, it shall also file a reconciliation of the account balances set forth in that report (both total company and North Carolina) with the account balances set forth in the annual cost of service studies filed with the Commission.

f. That no portion of the total ARO asset or liability shall be included in rate base for North Carolina retail accounting or ratemaking purposes.

g. That no portion of the total ARO asset or liability shall be included in the Construction Work in Progress base to which Duke applies its AFUDC [Allowance for Funds Used During Construction] rate.

h. That neither the depreciation rates utilized by Duke nor the depreciable bases to which it applies those rates shall be changed due to the implementation of SFAS 143.

i. That Duke shall file with the Commission the journal entries setting forth the initial implementation of SFAS 143 and all other entries related to SFAS 143 for calendar year 2003, as well as all entries implementing the deferrals allowed by the Commission's Orders.

j. That all entries made and amounts recorded as a result of the implementation of SFAS 143 and the deferrals allowed by the Commission's Orders shall be subject to ongoing review by the Commission, the Public Staff, and other parties to this docket.

k. That the deferral accounting treatments allowed by the Commission's Orders shall not prejudice any party from taking issue with the amount or the treatment of any deferral of ARO costs in a rate or other appropriate proceeding, including a proceeding initiated in

Docket No. E-100, Sub 56 for the purpose of determining nuclear decommissioning expenses.

3. That the Commission, in its Order issued April 4, 2003, in this docket, did not intend to, and did not, modify the regulatory treatment previously established for cost of removal obligations associated with assets that are not legal AROs.

4. That, absent an explicit Commission order to the contrary, Duke shall continue to accrue cost of removal obligations associated with assets that are not legal AROs through its depreciation rates as prescribed most recently in the Commission Order ruling on the Company's application for a general rate increase in Docket No. E-7, Sub 487.

5. That Duke shall submit all proposed changes in the cost of removal for all long-lived assets and/or in the accounting for such costs, if any, to the Commission for its approval prior to implementation. Such changes, when submitted, shall be considered in the context of a general rate case or other appropriate proceeding.

6. That, except as modified herein, the Commission Order issued April 4, 2003, in this docket, shall remain in full force and effect.

ISSUED BY ORDER OF THE COMMISSION.

This the 8th day of August, 2003.

NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

Chairman Jo Anne Sanford and Commissioner Lorinzo L. Joyner did not participate.

DH080703.01

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH
Docket No. E-2, Sub 1103
Docket No. E-7, Sub 1110

In the Matter of	)	
Joint Petition of Duke Energy Progress, LLC	)	COMMENTS
and Duke Energy Carolinas, LLC for an	)	OF THE
Accounting Order to Defer Environmental	)	ATTORNEY GENERAL'S
Compliance Costs	)	OFFICE

The North Carolina Attorney General's Office ("AGO") respectfully submits these comments regarding the joint petition ("Joint Petition") of Duke Energy Progress, LLC ("Duke Progress") and Duke Energy Carolinas, LLC ("Duke Carolinas") (collectively, "Duke Energy") requesting issuance by the Commission of "an accounting order for regulatory accounting purposes authorizing [Duke Energy] to defer in a regulatory asset account (until [Duke Energy's] next base rate cases) certain costs incurred in connection with compliance with federal and state environmental requirements as it relates to Coal Combustion Residuals ("CCRs" or "coal ash")."[1]

Introduction

The coal ash costs that Duke Energy seeks to recover are out-of-the-ordinary and very concerning because they may result in large rate increases for consumers. There are important questions that need to be addressed regarding whether all of the costs that Duke Energy seeks to recover were reasonably and prudentially incurred. It would not be appropriate to make important, binding, substantive determinations regarding recovery of these costs in a procedural,

[1] Joint Pet. at 1.

accounting-related docket. The Commission should ensure that all of the issues regarding coal ash cost recovery will not be resolved or prejudged until there is a complete evidentiary record in the upcoming rate cases. The Commission should direct Duke Energy to record the costs temporarily in the FERC USOA balance sheet asset account entitled Account 186 – Miscellaneous Deferred Debits, or another appropriate account, and to state that the authorization for temporary deferral pending a hearing on the merits does not provide any presumptions in favor of Duke Energy. [2] This will provide all parties to the proceeding with an opportunity to make all legal and substantive arguments during the rate case and its accompanying evidentiary proceedings. It would not be in the public interest for recovery issues to be decided prematurely prior to the rate case.

Factual Background

On 22 December 2008, the failure of a dike that was used to contain coal ash at a Tennessee Valley Authority plant resulted in 5.4 million cubic yards of coal ash waste being released into the Emory River.[3] In 2009, the EPA released its list of forty-four coal-fired power plant waste sites with "high hazard potential."[4]

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[2] This approach was used by the Commission in Order Denying Request to Implement Rate Rider and Scheduling Hearing to Consider Request for Creation of Regulatory Asset Account, In the Matter of Duke Energy Carolinas, LLC for Approval of Rate Rider to Allow Prompt Recovery of Costs Related to Purchases of Capacity Due to Drought Conditions in Docket No. E-7, Sub 849, issued 2 June 2008 ("2008 Duke Carolinas Drought Accounting Order Request") at 23.

[3] *See, e.g.*, U.S. Environmental Protection Agency and Tennessee Valley Authority Kingston Coal Ash Release Site Project Completion Fact Sheet, December 2014, https://www.epa.gov/sites/production/files/2016-02/documents/projectcloseout_dec2014_factsheet.pdf.

[4] *See, e.g.*, *EPA list shows dangerous coal ash sites found in 10 states*, June 29, 2009, McClatchy, available at http://www.mcclatchydc.com/news/nation-world/national/article24543913.html.

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Twelve of these sites were in North Carolina; ten were operated by Duke Energy Carolinas and two by Progress Energy Carolinas.[5]

On 21 June 2010, the EPA solicited comments on the regulation of coal ash, laying out two possible regulatory scenarios.[6] Both involved requiring liners for coal ash ponds and groundwater monitoring; one also required closure of coal ash ponds.[7] On 2 February 2014, as a result of the failure of Duke Carolinas to properly maintain and inspect two stormwater pipes running underneath the primary coal ash basin at its Dan River Steam Station in Eden, a pipe failed and resulted in the discharge of approximately 27 million gallons of coal ash wastewater and between 30,000 and 39,000 tons of coal ash into the Dan River.[8] Duke Carolinas, Duke Progress, and Duke Energy Business Services were charged with criminal violations of federal environmental laws, and on 14 May 2015 they pled guilty to nine counts, involving unlawful discharges and/or failures to maintain coal ash impoundments at H.F. Lee Steam Electric Plant, Cape Fear Steam Electric Plant, Asheville Steam Electric Plant, Riverbend Steam Station, and Dan River Steam Station.[9]

Following the Dan River spill, the North Carolina General Assembly passed the Coal Ash Management Act of 2014, which, among other things,

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[5] *Id.*
[6] Hazardous and Solid Waste Management System; Disposal of Coal Combustion Residuals From Electric Utilities, Part II, 80 FR 21302, 21303 (Apr. 17, 2015).
[7] *Id*.
[8] *United States v. Duke Energy Business Services, LLC et al*., Joint Factual Statement ¶ 1 (5:15 CR 2, 5:15 CR 67, 5:15 CR 68, May 14, 2015).
[9] *United States v. Duke Energy Business Services, LLC et al.,* Plea to Criminal Information and Sentencing Hearing Before Judge Malcolm J. Howard, 5:15-cr-00067-H, doc. 68; Joint Factual Statement, doc. 67 (May 14, 2015).

required closure of coal ash ponds in North Carolina.[10] The EPA published its final coal ash regulations on 17 April 2015, with an effective date of 14 October 2015.[11]

On 7 November 2014 Duke Energy Corporation filed its Form 10-Q for the quarter ending 30 September 2014, recording an asset retirement obligation ("ARO") of $3.423 billion "based upon the legal obligation for closure of coal ash basins and the disposal or related ash as a result of the Coal Ash Act and the agreement with [the South Carolina Department of Health and Environmental Control]."[12] Shortly thereafter, Duke Energy began incurring the expenses for which it now seeks deferred regulatory accounting treatment: "Expenses incurred for state and federal compliance and requested for deferral (January 2015 – November 2016) include $434.4 million for [Duke Carolinas] and $291.9 million for [Duke Progress]."[13]

Duke Energy has recorded Asset Retirement Obligations ("AROs") on its Condensed Consolidated Balance Sheets as of September 30, 2016 in the amount of $4.5 billion, based on the estimated legal obligation for closure of coal ash basins and the disposal of related coal ash to comply with state and federal environmental requirements;[14] however, Duke Energy states that total actual compliance costs incurred could be materially different from these estimates.[15]

[10] North Carolina General Assembly S.B. 729, Part II (Aug. 20, 2014).
[11] 80 FR 21302, 21302.
[12] Duke Energy, Quarterly Report (Form 10-Q) at 56, 50 (Nov. 7, 2014).
[13] Joint Pet. at 2.
[14] Joint Pet. at 4-5.
[15] *Id*. at 9.

Procedural History

On 21 December 2015, Duke Energy sent a letter to the Commission, called "Explanation of Accounting Treatment Related to Coal Ash Basin Obligations."[16] In the letter, Duke Energy informed the Commission that it had accounted for its ongoing and expected coal ash expenses by recording an ARO, as required by GAAP and Federal Energy Regulatory Commission Uniform System of Accounts and General Instruction No. 25.[17] It further informed the Commission that it had created a regulatory asset account.[18] Specifically, Duke Energy asserted that "[t]he Commission has issued orders allowing the companies to defer all impacts of establishing an ARO until these costs can be considered in future ratemaking decisions."[19] Duke Energy noted that in addition to accounting for its coal ash-related ARO as required by GAAP, it was also "recording a debt and equity return ('carrying charge') on the [ARO] net asset for regulatory purposes."[20] It is currently deferring the equity portion of the carrying charge "until rate recovery has begun" but had already recorded approximately $2.7 million as "the debt return" through November 30, 2015.[21]

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[16] Joint Pet., Ex. 1.
[17] *Id*. at 1.
[18] *Id*. at 6.
[19] *Id*. at 2, citing Order Granting Motion for Reconsideration and Allowing Deferral of Costs In the Matter of Duke Power's Petition for Authority to Place Certain Asset Retirement Obligation Costs In a Deferred Account, Docket No. E-7, Sub 723 (August 8, 2003) ("2003 Duke Power Order") at 11; and the Order Granting Motion for Reconsideration and Allowing Deferral of Costs In the Matter of Carolina Power & Light Company's Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account, Docket No. E-2, Sub 826 (August 12, 2003) ("2003 Duke Carolinas Order") at 11 (collectively the "2003 Orders").
[20] *Id*. at 7.
[21] *Id*. at 8.

Duke Energy stated that authority to defer the costs was not being requested "at that time due to significant litigation and reconsiderations related to CAMA, the now-defunct Coal Ash Management Commission, and numerous other outstanding issues."[22]

On 28 March 2016, the Commission issued an Order Acknowledging Receipt of Filing and created formal dockets related to the establishment of AROs and attendant regulatory assets associated with coal ash costs. The Commission noted that it was not taking any action to address the accounting method announced by Duke Energy, because Duke Energy had not requested any Commission action.[23] The Commission stated that its order "should not be construed as agreement or disagreement with the substance of Duke's analysis or the conclusions Duke reaches."[24]

On 30 December 2016, Duke Energy filed the Joint Petition. In the Joint Petition, Duke Energy requests Commission approval to use Account 182.3 to defer the actual costs incurred,[25] specifically, "to defer to a regulatory asset, until the effective date of new rates from the next base rate case, all non-capital costs as well as the depreciation expense and cost of capital at the weighted average cost of capital for all capital costs" related to activities required to comply with the federal and state regulations.[26] In addition, Duke Energy requests approval to

[22] *Id.* at 10-11.
[23] Order Acknowledging Receipt of Filing at 1.
[24] *Id*. at 1-2.
[25] Joint Pet. at 13.
[26] *Id*. at 14.

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defer a cost of capital on the deferred costs at the weighted average cost of capital.[27]

Duke Energy informed the Commission that it intends to file general rate cases within twelve months of the filing date of the Joint Petition in order to address the prudency and ratemaking effects of the costs.[28]

Analysis

I. The Significant Factual Issues Raised by the Joint Petition Should Be the Subject of an Evidentiary Hearing.

The North Carolina Public Utilities Act provides that all rates by public utilities "shall be just and reasonable." N.C. Gen. Stat. 62-131(a). Moreover, all rates must be fair to the consumer. "[T]he Commission shall fix such rates as shall be fair both to the public utilities and to the consumer." N.C. Gen. Stat. 62-133(a).

There are a number of significant factual issues posed by Duke's request for cost deferral that require an evidentiary hearing for valid determination. North Carolina law provides that "[t]he Commission shall render its decisions upon questions of law and of fact in the same manner as a court of record."[29] Because of the number and complexity of the issues posed by the Joint Petition, it is appropriate for the Commission to allow Duke Energy to temporarily record its coal ash costs in the FERC USOA balance sheet asset account 186 (Miscellaneous Deferred Debits) or another appropriate temporary deferral account pending a hearing and final Commission determination as was ordered

[27] *Id*.
[28] *Id.* at 13.
[29] N.C. Gen. Stat. § 62-60 (2016).

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in the 2008 Duke Carolinas Drought Accounting Order Request.[30] Here, as then, "an evidentiary hearing is equitable, appropriate, and necessary" to resolve the questions of whether a request to create a regulatory asset is appropriate legally and as a matter of regulatory policy.[31]

The costs at issue are large, complex, and out-of-the-ordinary and need to be determined in a docket where there is sufficient transparency, where the parties have sufficient time to analyze the details of the costs for which Duke Energy seeks to recover and to conduct full and appropriate discovery, and where Duke Energy provides sufficient details on the record for the Commission to make a thorough and appropriate determination regarding the issue. The burden is on Duke Energy when it seeks recovery of such costs, and the Commission needs to give full consideration to the issue in order to protect the public interest.

II. The Commission Should Not Prematurely Reach Decisions on Substantive Cost Recovery Issues.

In two orders entered in 2003, the Commission stated that the predecessors to Duke Progress and Duke Carolinas should seek approval of the Commission prior to changing the accounting for the costs of removal of long term assets (*e.g.*, such as the costs of closing coal ash basins).[32] The 2003 Orders addressed an issue created by a new rule, SFAS 143, adopted by the Financial Accounting Standards Board ("FASB"), which required Progress

[30] 2008 Duke Carolinas Drought Accounting Order Request at 20.
[31] *Id*.
[32] *See* 2003 Duke Carolinas Order at 13; 2003 Duke Progress Order at 13-14 (emphasis added); *See* Joint Pet. Ex. 1 at 2 and fn 1 therein citing the 2003 Orders. SFAS 143 is now known as ASC 410-20, the same accounting rule in play in this matter. *See* Joint Pet. Ex. 1 at 5.

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Energy Carolinas and Duke Power to change the way certain AROs were accounted for under GAAP.[33] FASB had recognized that GAAP accounting and regulatory accounting could differ for AROs, and accordingly authorized utilities to recognize a regulatory asset or liability for the difference between the two accounting approaches.[34] The two companies had filed their petitions seeking permission to do just that, create a regulatory deferred account so that they could "place all income statement impacts arising from the … adoption of [the new GAAP rule] in regulatory deferred accounts." [35]

The Commission granted permission to create the regulatory deferred account subject to certain express conditions, including that 1) "the intent and outcome of the deferral process [approved for asset retirement obligation accounting] shall be to continue the Commission's currently existing accounting and ratemaking practices for nuclear decommissioning costs and other ARO costs," and 2) the utility "shall submit all proposed changes in the cost of removal for all long-lived assets and/or in the accounting for such costs, if any, to the Commission for its approval prior to implementation. Such changes, when submitted, shall be considered in the context of a general rate case or other appropriate proceeding."[36] The Commission specifically recognized that the cost of removal of assets had been a component of the depreciation rates for both Duke Carolinas and Duke Progress, that costs were being accrued in rates over the useful life of the related assets, and that the treatment of depreciation was

[33] 2003 Duke Carolinas Order at 1; 2003 Duke Progress Order at 1.
[34] *Id*.
[35] 2003 Duke Carolinas Order at 2; 2003 Duke Progress Order at 2.
[36] *See* 2003 Duke Carolinas Order at 13; 2003 Duke Progress Order at 13-14 (emphasis added).

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not to be changed by the implementation of SFAS 143.[37] The Commission drew a clear line between what was required for GAAP accounting and what the Commission required: "the intent and outcome of the deferral process shall be to continue the Commission's currently existing accounting and ratemaking practices for nuclear decommissioning costs and other ARO costs."[38]

On 28 March 2016, several months after Duke Energy filed the 21 December 2015 letter, the Commission issued an Order in which it acknowledged the receipt of the letter and created formal dockets related to the establishment of AROs and attendant regulatory assets associated with coal ash costs. As noted above, the Commission did not take any action to address the accounting changes announced by Duke Energy, observing that Duke Energy had not requested any Commission action. The Commission stated that its action "should not be construed as agreement or disagreement with the substance of Duke Energy's analysis or the conclusions Duke reaches."

III. Any Order Granting Duke Energy's Joint Petition In Whole or In Part, Should Be Without Prejudice to Any Party's Right To Contest In Future Ratemaking Proceedings the Appropriateness of Recovery of Coal Ash-Related Costs to Ratepayers.

Duke Energy acknowledges that it would be appropriate for the Commission to review its coal ash costs "in broad scope" in a future setting, such

[37] 2003 Duke Carolinas Order at 10-12; 2003 Duke Progress Order at 11-12. This is one of the factors that distinguishes the Joint Petition from Piedmont Natural Gas's application for deferred accounting on which Duke Energy relies. Joint Pet. at 14. In the case of Piedmont's expenses for addressing new US Department of Transportation regulations, the costs were "entirely distinct and different in nature from its historical [operations and maintenance] expenses. In the Matter of Application of Piedmont Natural Gas Company, Inc. for Approval of Deferred Accounting Treatment of Interim Pipeline Integrity Management Regulation Compliance Costs Dockets G-9, Sub 495 and G-21, Sub 457, Order Approving Deferred Accounting Treatment at 1 (2 December 2004). In addition, Piedmont requested the deferred accounting prior to incurring expenses. *Id*.

[38] 2003 Duke Carolinas Order at 12-13; 2003 Duke Progress Order at 12.

as a rate proceeding.[39] The AGO does not oppose postponing this inquiry to a future ratemaking case, and submits that—without limitation—the factors set out below are among those that should be preserved for future review and consideration:

Reasonableness and prudence. Among other factors, it is pertinent for the Commission to assess whether the construction, operation and management of Duke Energy's coal ash sites have been reasonable and prudent, as well as whether the clean-up costs were reasonably and prudently incurred.[40] Duke Energy also asks for this issue to be preserved for consideration in future proceedings.[41]

In addition, Duke Energy's deferral request seeks full recovery of coal ash costs from ratepayers.[42] However, the Commission has previously concluded that in some instances it is not appropriate for ratepayers to relieve shareholders of all responsibility for the environmental clean-up of utility sites by transferring such costs to current ratepayers.[43] In the context of deferred accounting requests, this Commission has stated that the full amount of major unexpected expenditures should not fall on ratepayers alone, but that there should be a fair division of such costs between ratepayers and shareholders, taking into account,

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[39] Joint Pet. at 1.
[40] The Commission describes these same factors in its discussion of cost recovery for environmental costs associated with manufactured gas plants in the Order Granting Partial Rate Increase *In the Matter of Application of Public Service Company of North Carolina, Inc., for an Adjustment of its Rates and Charges* issued 7 October 1994 in Docket No. G-5, Sub 327 ("1994 PSNC Rate Case") at 22.
[41] *See* Joint Pet. at 1.
[42] Joint Pet. at 2.
[43] 1994 PSNC Rate Case at 23.

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among other things, whether the utility has achieved a reasonable level of earnings during the period for which it seeks deferred accounting.[44]

Legal prohibitions on recovery. Duke Energy states that it does not seek deferral of any costs associated with the Dan River pipe break repair and spill cleanup, and nor will it seek recovery of such costs in future rate recovery.[45] Under North Carolina law, "[t]he Commission shall not allow an electric public utility to recover from the retail electric customers of the State costs resulting from an unlawful discharge to the service waters of the State from a coal combustion residuals surface impoundment."[46] Under its plea agreements, Duke Energy cannot seek a rate increase based on compliance with the criminal fines, restitution related to the counts of conviction, community service payments, its mitigation obligations under the plea agreement, the costs of the Dan River clean up, and/or the funding of the environmental compliance plans required under its plea agreements.[47] The accounting details are important in this context and, accordingly, whether and the extent to which these types of costs are included in Duke Energy's request for recovery should be examined in the context of a developed evidentiary record.

Recovery of carrying costs. Whether Duke Energy may recover carrying costs (*e.g.*, in the event coal ash costs are amortized, whether it is appropriate for Duke Energy to earn a rate of return on the unamortized balance) is an issue

[44] 2008 Duke Carolinas Drought Accounting Order Request at 10.
[45] Joint Pet. at 2.
[46] N.C. Gen. Stat. § 62-133.13.
[47] *United States v. Duke Energy Business Services, LLC et al.,* Plea to Criminal Information and Sentencing Hearing Before Judge Malcolm J. Howard, 5:15-cr-00067-H, doc. 68 at 38 (May 14 2015).

that may be contested in the rate proceedings. The Commission has previously disallowed the recovery of carrying costs associated with the clean-up of manufactured gas plants.[48] Here, it is appropriate for the Commission to consider what rate of return Duke Energy should receive in light of the nature of the costs Duke Energy seeks to recover.

Propriety of recovery in light of cost recovery through depreciation or other methods. Duke Energy notes that the current rates for Duke Progress include a component for coal ash remediation costs as part of the Cost of Removal included in depreciation rates but does not explain in detail how Duke Carolinas has addressed such costs for recovery over the useful life of the assets.[49] One of the factors that may be contested is the extent to which Duke Energy has already collected some coal ash costs through past rates.

Appropriate contribution from insurance proceeds or responsible third parties. Another factor that Duke Energy may need to address is whether insurance or third party sources are or may be responsible to fund or contribute to coal-ash related costs.

Conclusion

The Commission should ensure that all of the substantial issues regarding cost recovery will not be resolved or prejudged until there is a complete evidentiary record in the upcoming rate cases. The Commission should direct Duke Energy to set up a temporary regulatory asset on its books so that all of the factual and legal issues raised by the Joint Petition can be fully reviewed on an

[48] *See* 1994 PSNC Rate Case at 23.
[49] Joint Pet. at 5.

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evidentiary record and without prejudice to the ability of any party to raise other cost recovery related issues at the rate case.

Respectfully submitted, this the 15th of March, 2017.

JOSH STEIN
Attorney General

/s/ Margaret A. Force
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CERTIFICATE OF SERVICE

The undersigned certifies that she has served a copy of the foregoing INITIAL COMMENTS OF THE ATTORNEY GENERAL'S OFFICE upon the parties of record in this proceeding by electronic mail.

This the 15th day of March, 2017.

/s/ Margaret A. Force
Margaret A. Force
Assistant Attorney General

I/A

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April 19, 2017

Ms. M. Lynn Jarvis
Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, NC 27699-4300

RE: In the Matter of Joint Petition of Duke Energy Progress, LLC and Duke Energy Carolinas, LLC, for an Accounting Order to Defer Environmental Compliance Costs
Docket No. E-2, Sub 1103
Docket No. E-7, Sub 1110

Dear Ms. Jarvis:

Pursuant to the Order Granting Extension of Time to File Reply Comments entered April 7, 2017, please find enclosed for filing in the above-referenced Duke Energy Progress, LLC and Duke Energy Carolinas, LLC's Reply Comments in Support of its Joint Petition for an Accounting Order to Defer Environmental Compliance Costs.

If you have any questions, please let me know.

Sincerely,

Heather Shirley Smith

Heather Shirley Smith

HSS/ksh

I/A

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-2, SUB 1103
DOCKET NO. E-7, SUB 1110

In the Matter of Joint Petition of Duke Energy Progress, LLC, and Duke Energy Carolinas, LLC, for an Accounting Order to Defer Environmental Compliance Costs	)))))	**DUKE ENERGY PROGRESS, LLC AND DUKE ENERGY CAROLINAS, LLC'S REPLY COMMENTS IN SUPPORT OF ITS JOINT PETITION FOR AN ACCOUNTING ORDER TO DEFER ENVIRONMENTAL COMPLIANCE COSTS**

NOW COMES Duke Energy Progress, LLC ("DEP") and Duke Energy Carolinas, LLC ("DEC") (collectively the "Companies"), by and through counsel, pursuant to the North Carolina Utilities Commission's ("Commission") January 6, 2017 *Order Requesting Comments* and its March 9, 2017 *Order Granting Additional Extensions of Time to File Comments*, and respectfully submits their Reply Comments in support of the Companies' Joint Petition for an Accounting Order to Defer Environmental Compliance Costs. With these Reply Comments, the Companies respectfully reaffirm their respective requests that the Commission issue an order authorizing the Companies to defer certain regulatory compliance obligations as a regulatory asset in Account 182.3—Other Regulatory Assets, pending Commission review of the reasonableness and prudence of these costs in future general rate case proceedings to be filed later this year. In support of these Reply Comments, the Companies respectfully submit to the Commission the following:

RELEVANT BACKGROUND

1. On December 30, 2016, the Companies jointly filed a Petition for an Accounting Order ("Petition") in the above-captioned dockets requesting that the Commission issue an Order authorizing the Companies to defer in a regulatory asset account certain costs of compliance with federal and state environmental requirements regarding coal combustion residuals ("CCRs"). In the Petition, the Companies described their ongoing efforts to comply with new environmental requirements related to the Environmental Protection Agency's ("EPA") final rule[1] ("CCR Rule") and the North Carolina Coal Ash Management Act ("CAMA"). The Petition detailed the significant projected costs to comply with the CCR Rule and CAMA and, relatedly, the significant projected financial impact to the Companies in light of these new and extraordinary regulatory obligations. The Companies also noted that they each intend to file a base rate case within the next 12 months.

2. On January 6, 2017, the Commission entered its *Order Requesting Comments*, permitting interested parties to submit comments regarding the Petition no later than February 15, 2017, and directing the Public Staff to file its comments no later than March 15, 2017.

3. On March 8, 2017, the Public Staff filed a motion requesting that the due dates for initial comments and reply comments be extended to March 15, 2017, and April 12, 2017, respectively. The Commission issued its *Order Granting Additional Extensions of Time to File Comments* on March 9, 2017, granting the Public Staff's request.

4. Also on March 8, 2017, NC WARN, Appalachian State University ("ASU"), and the Cities of Concord and King's Mountain ("Cities")[2] filed initial comments. The Public Staff, the Attorney General's Office (the "Attorney General"), and the Carolina Utility Customers

[1] *Hazardous and Solid Water Mgmt. System; Disposal of Coal Combustion Residuals from Elec. Utils.*, 80 FR 21301 (Apr. 17, 2015).

[2] The Cities and ASU filed separate but identical comments.

Association, Inc. ("CUCA") filed comments on March 15, 2017. In these Reply Comments, the Companies refer to the comments filed by ASU, the Attorney General, the Cities, the CUCA, NC WARN and the Public Staff, collectively as the "Comments," and the parties to the proceeding as the "Intervenors."

5. Collectively, the Intervenors do not raise any issues that should affect the Commission's review of the Companies' accounting request. Of note, no intervenor directly asserted that the Companies' request for deferral accounting should be denied in its entirety. In fact, the Public Staff affirmatively stated that the Companies' non-capital costs and depreciation expense related to state and federal requirements meet the criteria for deferral.[3] The Companies' request meets the well-established standard for granting deferral accounting authority in terms of the magnitude and extraordinary nature of the costs incurred and the resulting impact on the Companies' financial condition. Therefore, the Commission should approve the request, subject only to the condition that rate recovery issues should be decided in their upcoming general rate cases to be filed later in 2017. Because the Companies will file general rate cases within the year, it is not necessary to establish a hearing to examine the reasonableness and prudence of the costs sought to be deferred. Indeed, Intervenors' Comments predominately addressed cost recovery matters more appropriately raised in the general rate case proceedings. In addition, Intervenors request several adjustments to the Companies' proposed accounting entries. The Companies do not object to the Public Staff's request that determinations about the amortization of the deferred expenses should be delayed and decided on in the next respective general rate proceedings. However, the Intervenors' other arguments requesting more granularity in the Companies' accounting are not necessary for this proceeding.

[3] Public Staff Comments at p. 6 ("In this particular case, the Public Staff believes that the non-capital costs and depreciation expense related to compliance with state and federal requirements cited in the Companies' petition generally satisfy the criteria for deferral for regulatory accounting (but not necessarily ratemaking) purposes.").

REPLY TO COMMENTS

A. The Petition Satisfies the Commission's Requirements for Deferral

1. The Petition Meets the Standard for Deferral

6. When considering a request for deferral, the Commission evaluates: 1) the extraordinary nature and uniqueness of the costs requested to be deferred (and the magnitude of the costs); and 2) whether, absent authorizing deferral, the costs would have a material impact on the company's financial condition.[4] When evaluating the public utility's financial condition, the Commission reviews the impact on the company's achieved level of earnings during the requested deferral period.[5] The Commission may also consider "whether the company has requested, or is contemplating requesting, a general rate increase and the timing, or the proposed timing, of the filing of such a request."[6]

7. The Companies' request meets the Commission's criteria for granting deferral. None of the Intervenors dispute the basis for the Companies' request: 1) the Federal government and State of North Carolina have adopted significant new legislation and regulatory requirements obligating the Companies to spend significant amounts to comply with the CCR Rule and CAMA;[7] and 2) denial of the request would adversely affect the Companies' financial stability.[8] As shown in the Petition (and not disputed by the Intervenors), the adverse impact to earnings, as

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[4] Public Staff Comments at pp. 4-5 (citing *In the Matter of Petition of Duke Energy Carolinas, LLC for an Accounting Order to Defer Certain Environmental Compliance Costs and the Incremental Costs Incurred From the Purchase of a Portion of Saluda River's Ownership in the Catawba Nuclear Station*, NCUC Docket No. E-7, Sub 874, *Order Approving Deferral Accounting with Conditions*, (Mar. 31, 2009); *In the Matter of Petition of Duke Energy Carolinas, LLC for an Accounting Order to Defer Certain Capital and Operating Costs Incurred for the Advanced Clean Coal Cliffside Unit 6 Steam Generating Plant, the Dan River Natural Gas Combined Cycle Generating Plant, and the Capacity-Related Modifications at the McGuire Nuclear Generating Plant*, NCUC Docket No. E-7, Sub 1029, *Order Approving in Part and Denying in Part Request for Deferral Accounting* (Apr. 3, 2013) ("*Generator Deferral Order*").

[5] *See Generator Deferral Order* at pp. 12-13.

[6] *Generator Deferral Order* at p. 10 (referencing order in NCUC Docket No. E-7, Sub 874 where the Commission found that "the financial consequences and the fact that the Company was planning to file a rate case in the near term warranted deferral").

[7] Petition at PP 5-14.

[8] Petition at PP 15-.

calculated for the 12-month period ending September 30, 2016, was 244 basis points for DEP and 247 basis points to DEC.[9] Furthermore, the Companies reiterate their intent to file general rate cases during 2017 where all issues related to recoverability of the deferred costs will be determined. Indeed, none of the Intervenors even requests that the Commission deny the Petition in its entirety.[10] The Public Staff affirmatively states that the Companies' non-capital costs and depreciation expense related to state and federal requirements generally meet the Commission's criteria for deferral.[11] The Attorney General notes that it "is appropriate for the Commission to allow [the Companies] to temporarily record its coal ash costs" in FERC Account 186 or "another appropriate temporary deferral account pending a hearing and final Commission determination."[12] Other Intervenors only oppose the request in part by recommending that certain costs be carved out from the deferral. Such arguments should be rejected, as discussed in more detail below.

8. In short, the Companies' deferral request is appropriate based on Commission precedent, is consistent with the Commission's recent treatment of CCR-related asset retirement obligation ("ARO") costs borne by Dominion North Carolina Power ("Dominion") and authorized for deferral and recovery in that utility's 2016 general rate case,[13] and should be granted.

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[9] Petition at PP 18-19.

[10] CUCA, the Cities, and ASU, speculate as to inclusion of certain costs, issues best left to each Companies' general rate case, as discussed in more detail in PP 19-20 below.

[11] Public Staff Comments at p. 6 ("the Public Staff does not object to a deferral of these expenses for regulatory accounting purposes. . .").

[12] Attorney General's Comments at p. 7.

[13] Petition at p. 15 and n.9 (citing *In the Matter of Application of Virginia Electric & Power Company, d/b/a Dominion North Carolina Power, for Adjustment of Rates and Charges Applicable to Electric Utility Service in North Carolina*, NCUC Docket No. E-22, Sub 532, *Order Approving Rate Increase and Cost Deferrals an Revising PJM Regulatory Conditions* at p. 62 (Dec. 22, 2016) ("Based upon the entire evidence of record, the present Stipulation to allow the test year CCR costs to be recovered in this case by amortization over a five-year period with the unamortized balance to earn a return and the authorization to treat future CCR costs incurred through 2018 as a regulatory asset (which is the mechanism to facilitate the deferral of future CCR costs) is proper and in the public interest under the facts and circumstances of this case.")).

2. An Evidentiary Hearing on the Petition for Deferral is Not Necessary

9. The Attorney General states that there "are a number of significant factual issues posed by Duke's request for cost deferral that require an evidentiary hearing for a valid determination."[14] The Attorney General supports its request by referencing a different docket where the Commission ordered an evidentiary hearing to evaluate proposed regulatory asset accounting treatment.[15] NC WARN also requests that the Commission consider issues of coal ash cleanup in "a separate proceeding, rather than a rate case," and that the Commission conduct an evidentiary hearing.[16]

10. It is not necessary to establish an evidentiary hearing to examine the deferral request. While the Commission's review of CCR-related cost recovery will likely be complex, the issues underlying the deferral request are fairly simple and can be resolved on the written record. As described above, the Companies meet the criteria for deferral. The Companies are not obligated to show reasonableness and prudence of costs for the Commission to grant its requested accounting treatment.[17] Any costs deferred will be subject to evaluation of prudency and reasonableness by the Commission in the Companies' future general rate cases.

11. The Attorney General's reference to the Drought Proceeding is factually distinguishable and not relevant. DEC's primary request in that proceeding was for a cost recovery rider. With respect to the regulatory asset under consideration in the Drought

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[14] Attorney General's Comments at p. 7.

[15] Attorney General's Comments at pp. 2, 7 (citing *In the Matter of Application of Duke Energy Carolinas, LLC for Approval of Rate Rider to Allow Prompt Recovery of Costs Related to Purchases of Capacity Due to Drought Conditions*, NCUC Docket No. E-7, Sub 849, *Order Denying Request to Implement Rate Rider and Scheduling Hearing to Consider Request for Creation of Regulatory Asset Account* (June 2, 2008) ("*Drought Proceeding Order*")). This proceeding will be referred to as the "Drought Proceeding" in these Reply Comments.

[16] NC WARN Comments at p. 5.

[17] *See, e.g., In the Matter of Petition of Duke Energy Carolinas, LLC for an Accounting Order to Defer Certain Environmental Compliance Costs and Incremental Costs Incurred from the Purchase of a Portion of Saluda River's Ownership in the Catawaba Nuclear Station*, NCUC Docket No. E-7, Sub 874, *Order Approval Deferral Accounting with Conditions*, at p. 19 (Mar. 31, 2009) (Commission approving deferral without reviewing prudency issues) ("*2009 DEC Deferral Order*").

Proceeding, DEC requested that the accounting treatment be granted "with the assurance that the Company may recover such costs in the future."[18] Thus, DEC's request for ongoing deferral treatment in the Drought Proceeding was distinguishable from the instant request for deferred accounting, as DEC did not propose a hearing process to thoroughly examine the reasonableness and prudence of the deferred costs in the near future, such as in the Companies' upcoming general rate cases.[19]

12. This request is more analogous to Commission proceedings evaluating deferral of extraordinary costs associated with environmental compliance, where the Commission has recognized and expressly mandated that the deferral period is not open-ended and the Commission and all interested parties will have full rights to address cost recovery in upcoming general rate cases.[20] Indeed, the Commission has expressly held in the past – and the Companies do not oppose here – that deferral accounting treatment of extraordinary costs is approved "without prejudice to the right of any party to take issue with the amount, if any, of the deferred costs to be allowed for ratemaking purposes, if such costs are included in future rate filings,"[21] as requested by the Public Staff.[22] Of note, Public Staff and CUCA request that the Commission affirmatively further condition deferral.[23] It is not necessary for the Commission to attach any additional conditions for deferral as such amounts will be subject to the reasonable and prudent cost standard in the upcoming base rate proceedings.

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[18] *Drought Proceeding Order* at p. 19.
[19] *Drought Proceeding Order* at p. 20.
[20] *See DEC 2009 Deferral Order* at p. 19 (Mar. 31, 2009) (Commission approving deferral of costs associated with increased ownership interest in the Catawaba Nuclear Station and putting in service Allan scrubbers without instituting hearing as requested by commenters, noting that DEC was "currently contemplating filing an allocation for a general rate increase in the near term").
[21] *See, e.g., DEC 2009 Deferral Order* at p. 20.
[22] Public Staff Comments at p. 6.
[23] For example, the Public Staff asks the Commission to recognize in its order that, in light of the complexity of this proceeding, "any assumptions regarding [] rate recovery should be especially discouraged." Public Staff Comments at p. 6. The CUCA requests that the Commission "make clear" that costs related to "fines or penalties, lobbying costs or litigation related to coal ash, or any negligent coal ash practices by Duke" should not be deferred or flowed through rates. CUCA Comments at p. 2.

3. Costs of the CCR Rule and CAMA Compliance are Properly Included in the Deferral Request

13. While the Public Staff and the Attorney General do not oppose the Companies' deferral requests, CUCA, ASU, and the Cities each in some form argue that some of the costs in question may not be eligible for deferral because Section A13 of the Statement of Financial Accounting Standards ("SFAS") No. 143[24] excludes from consideration "environmental remediation liability that results from the improper operation of a long lived asset."[25] Subsection (b) of ASC 410-20-15-3 states in full:

> An environmental remediation liability that results from the improper operation of a long-lived asset (see Subtopic 410-30). Obligations resulting from improper operations do not represent costs that are an integral part of the tangible long-lived asset and therefore should not be accounted for as part of the cost basis of the asset. For example, a certain amount of spillage may be inherent in the normal operations of a fuel storage facility, but a catastrophic accident caused by noncompliance with an entity's safety procedures is not. The obligation to clean up the spillage resulting from the normal operation of the fuel storage facility is within the scope of this Subtopic. The obligation to clean up after the catastrophic accident results from the improper use of the facility and is not within the scope of this Subtopic.

CUCA alleges (without support) that "CAMA was written in response to the Dan River spill," such that including CAMA costs in the deferral "may be counter to the standards of SFAS No. 143."[26] Building on this unsubstantiated premise, CUCA requests that the Commission "establish a deferred asset only for CCR-related Costs and allow Duke to present its argument for full recovery of all CAMA-related costs in the upcoming general rate case."[27] ASU and the Cities similarly comment that the Companies' accounting practices are "not sufficiently

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[24] SFAS No. 143 is now FASB Accounting Standards Codification ("ASC") 410-20-15-3(b), available for free with Basic View access at https://asc.fasb.org/section&trid=2175677#d3e5134-110843. For purposes of this document, we refer to the standard as using the current ASC codification.
[25] CUCA Comments at p. 3; ASU Comments at pp. 1-2; Cities Comments at pp. 1-2.
[26] CUCA Comments at p. 3.
[27] CUCA Comments at p. 3.

transparent" such that the Companies should be required to separately account for CAMA and CCR Rule compliance costs.[28]

14. The Companies disagree with the foregoing arguments as they reflect a misunderstanding of CAMA and a misapplication of the guidance in ASC 410-20-15-3(b). As to the ARO, CAMA relates to remaining CCRs that resulted from the normal operation of generating facilities—it precludes the costs of the Dan River spill. The costs of compliance with the CCR Rule and CAMA are asset retirement liabilities, consistent with ASC 410-20-15-3(b), because the costs are based on "legal obligations associated with the retirement of [] tangible long-lived asset[s] that result from the . . . normal operation"[29] of those facilities. Environmental compliance costs associated with retirement of a long-lived asset, such as those incurred to comply with the CCR Rule and CAMA, squarely fit within the meaning of "legal obligation." As such, the costs are properly deferred as a regulatory asset pursuant to ASC 980 (formerly SFAS 71) for the reasons previously discussed in Paragraphs 7 and 8 in these Reply Comments.[30] It is not appropriate to draw a line between the CCR Rule and CAMA. The Companies are required to comply with both the CCR Rule and CAMA.

15. The primary concern underlying CUCA's, ASU's and the Cities' request appears to be ultimate cost recovery and ensuring that costs associated with fines and penalties are not passed on to customers through rates.[31] The Companies reiterate their commitment that costs

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[28] ASU Comments at pp. 3-4; Cities Comments at pp. 3-4. ASU and the Cities also request separate accounting treatment for a number of other categories, discussed in more detail in [n.38] below.

[29] *See* ASC 410-20-15-2(a). "Legal Obligation" is defined as "[a]n obligation that a party is required to settle as a result of an *existing or enacted law, statute*, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel." *See* FASB ASC Glossary, available for free with Basic View access at https://asc.fasb.org/glossarysection&trid=2175680 (emphasis added).

[30] *See* FASB ASC 980-410-25-2, available for free with Basic View access athttps://asc.fasb.org/section&trid=2560838.

[31] *See, e.g.*, CUCA Comments at p.7 (requesting that the Commission "make it clear that any . . . costs related to fines or penalties, lobbying costs or ligation related to coal ash, or any negligent coal ash practices by Duke, should

associated with this deferral request do not include fines, penalties, or remediation costs associated with the Dan River pipe break repair and resulting spill cleanup.[32] To the extent the Intervenors are not satisfied with that commitment, the Commission will evaluate the appropriateness of cost recovery in the Companies' upcoming general rate cases. In fact, all three Intervenors that speculate about ASC 410-20-15-3(b) acknowledge that the costs will ultimately be reviewed by the Commission in a different proceeding.[33]

16. CUCA, ASU and the Cities also request a separation of CAMA costs from CCR Rule costs for purposes of the deferral.[34] It is impracticable, and in some cases impossible, to distinguish the costs of federal CCR Rule compliance from CAMA compliance. The obligations of the federal CCR Rule and CAMA are largely duplicative. To address regulatory obligations related to coal ash efficiently and comprehensively, the Companies have implemented a single compliance plan. While some costs are strictly attributable to CAMA, there is substantial overlap in the types of work required to be performed under the CCR Rule and under CAMA. It is appropriate to review the costs as a whole, as is reflected in the Companies' comprehensive compliance plan. There is nothing unusual about costs for environmental compliance being considered as programmatic in total where a confluence of requirements exists, including CAMA and the CCR Rule.

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neither be placed into the Deferred Account nor should any of these costs be flowed through to Duke's rate schedules for recovery from rate payers").

[32] Petition at p. 2.

[33] CUCA Comments at p. 3 ("A fundamental question that may be raised to this Commission, *at a later date*, is whether the costs incurred by Duke for compliance with CAMA were the result of improper operating of its coal ash ponds.") (emphasis added); ASU Comments at p. 3 ("As noted in Financial Accounting Standard 143, Asset Retirement Obligations should not be recorded for obligations that result from improper operations of an asset. These issues, undoubtedly, *will be addressed* in the upcoming rate proceedings.") (emphasis added); Cities Comments at p. 3 (making same comment as ASU).

[34] CUCA Comments at pp. 4-6; ASU Comments at p. 4; Cities Comments at p. 4.

B. The Companies' Requested Accounting Treatment is Appropriate

17. Intervenors make several requests about the manner and timing of accounting for the deferred costs. Public Staff requests that the Commission "delay determining the beginning date of any amortization of the deferred expenses until the next respective general rate proceedings."[35] The Companies do not object to Public Staff's request. The amortization period can be determined in general rate cases to be filed later this year.

18. The Attorney General requests that the Commission order the Companies to temporarily record costs in Account 186, pending the outcome of a hearing on deferral issues.[36] Again, the Attorney General references the Drought Proceeding to support its request for this accounting treatment.[37] As discussed above, it is not necessary to hold a hearing in this proceeding. The costs are currently booked to Account 186—Miscellaneous Deferred Debits. In the Petition, the Companies requested to move the costs to Account 182.3—Other Regulatory Assets. As discussed above, the Drought Proceeding primarily involved a request to establish a new cost recovery mechanism and secondarily the request for deferral. Here, issues of cost recovery will be examined in the Companies' upcoming general rate cases. Further, the FERC Uniform System of Accounts instructions for Account 182.3 specifically contemplate that costs in that account may be excluded from rates: "[i]f rate recovery of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426.5, Other Deductions, or Account 435, Extraordinary Deductions, in the year of the disallowance."[38] Thus, granting the accounting treatment requested in the Petition would not

[35] Public Staff Comments at p. 7.
[36] Attorney General's Comments at pp. 7-8.
[37] Attorney General's Comments at pp. 7-8.
[38] 18 C.F.R. Part 101, Account 183.2(c).

prevent the Commission from excluding a portion of the deferred costs from the Companies' rates if the Commission finds such costs were not prudently and reasonably incurred.

C. Issues Related to Cost Recovery Should Be Addressed in the Companies' Upcoming General Rate Cases

19. Intervenors' remaining arguments do not relate to the Companies' deferral request at all. Rather, Intervenors raise a litany of issues related to prudence and ultimate cost recovery,[39] all of which the Commission can fully vet in the context of a general rate case. For example, CUCA, ASU, and the Cities request that the Companies separately account for the costs subject to this proceeding.[40] The Public Staff and the Attorney General suggest that some level of cost sharing between the Companies' shareholders and customers may be appropriate.[41]

20. The Companies object to Intervenors' requests for more granular accounting of costs. For purposes of the deferral request, the Companies commit to follow generally accepted accounting principles regarding deferrals.[42] The Companies also object to Public Staff's and Attorney General's request for cost sharing between shareholders. These and other issues are superfluous and not relevant to this deferral proceeding. It would be premature for the Commission to delve into substantive review of the prudence or appropriateness of the costs sought to be treated as a regulatory asset in this proceeding because the request is expressly

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[39] *See, e.g.*, Public Staff Comments at pp. 7-8; NC WARN Comments at pp. 2-5; Attorney General's at pp. 11-13; CUCA Comments at 3; ASU Comments at 3-4; Cities Comments at 3-4.

[40] CUCA Comments at p. 6 (requesting that the Companies separate North Carolina costs from South Carolina costs and retail costs from wholesale costs); ASU Comments at p. 4 (requesting that costs be broken out into eight other categories: 1) costs related to Federal judgements; 2) costs related to EPA judgements; 3) costs associated with penalties imposed by any federal or state governmental body; 4) costs associated with complying with the terms of any of the federal or EPA proceedings listed; 5) costs incurred for lobbying efforts related to CCRs; 6) legal costs associated with coal ash-related proceedings; 7) goodwill payments made by the Companies; and 8) accrued returns); Cities Comments at p. 4 (making same request as ASU).

[41] Public Staff Comments at p. 6; Attorney General's Comments at pp. 11-13 and n.47 (citing case where Commission did not permit recovery of carrying costs associated with the cleanup of manufactured gas plants).

[42] As for ASU and the Cities' request to separate payments related to Federal, EPA, and any other judgements, as well as lobbying expenses, the Companies note that costs are not included in the Companies' deferral request. Per the Uniform System of Accounts, fines and penalties are booked in Account 426.3, and lobbying expenses are booked in Account 426.4. These are "below the line" accounts and are not part of this deferral request. The Companies decided not to include any costs for good will in their request.

limited to accounting treatment. The Companies will file a general rate case this year, as stated in the Petition. Intervenors and the Commission will have the opportunity at that time to thoroughly examine the appropriateness of cost recovery for the costs deferred as regulatory assets.

CONCLUSION

21. Because these costs meet the standard for deferral accounting—a fact that no Intervenor directly challenges—the Commission should grant the Companies' request, subject to the condition that such decision is without prejudice to the right of any party to take issue with the amount, if any, of the deferred costs to be allowed for rate making purposes, if such costs are included in future rate filings.

WHEREFORE, the Companies respectfully requests that the Commission consider these comments in reaching a decision on the Petition.

Respectfully submitted this 19th day of April, 2017.

DUKE ENERGY PROGRESS, LLC

DUKE ENERGY CAROLINAS, LLC

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I/A

CERTIFICATE OF SERVICE

I certify that a copy of Duke Energy Progress, LLC and Duke Energy Carolinas, LLC's Reply Comments in Support of its Joint Petition for an Accounting Order to Defer Environmental Compliance Costs, in Docket No. E-2 Sub 1103 and Docket No. E-7, Sub 1110, has been served on all parties of record either by electronic mail, hand delivery or by depositing a copy in the United States mail, postage prepaid.

This the 19th day of April, 2017

Heather Shirley Smith

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Duke Energy Carolinas
Response to
Attorney General's Office
Seventh Set of Data Requests
Data Request No. 7-1

Docket No. E-7, Sub 1146

Date of Request: **January 3, 2018**
Date of Response: **January 9, 2018**

☐ **CONFIDENTIAL**

☒ **NOT CONFIDENTIAL**

Confidential Responses are provided pursuant to Confidentiality Agreement

The attached response to Attorney General's Office Data Request No. 7-1, was provided to me by the following individual(s): Amber D. Williams, Lead Accounting Analyst, US Property Accounting, and was provided to Attorney General under my supervision.

John T. Burnett
Deputy General Counsel
Duke Energy Carolinas

AGO 7-1

Request:

Has Duke Carolinas included in its depreciation rates any costs for closure of ash impoundments?

a. If so, specifically identify the amounts accrued, both annually and in total, and the methodology for computing them.
b. Identify and produce any reports or studies upon which such costs are based.
c. If not, explain why not.

Response:

(a) Duke has not included in its depreciation rates any costs for closure of ash impoundments.

(b) Please refer to the response in (a).

(c) No final dismantlement costs of any kind were factored into the prior DEC depreciation study. It was assumed in the last dismantlement study that the salvage received for scrap would sufficiently offset the costs to dismantle. The previous DEC dismantlement study occurred prior to the passage of the CAMA and CCR legislation. The CAMA and CCR legislation have increased estimated ash impoundment closure costs by significant amounts and are recorded in accordance with Asset Retirement Obligation accounting guidance.