NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION

OFFICIAL COPY

Dec 04 2020

December 4, 2020

Ms. Kimberley A. Campbell, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4300

Re: Public Staff Late-Filed Exhibit No. 4 and 5
Docket No. E-2, Sub 1193 – Petition of Duke Energy Progress, LLC for an Accounting Order to Defer Incremental Storm Damage Expenses Incurred as a Result of Hurricanes Florence and Michael and Winter Storm Diego; and Docket No. E-2, Sub 1219 – Application of Duke Energy Progress, LLC for Adjustment of Rates and Charges Applicable to Electric Service in North Carolina

Dear Ms. Campbell:

Per the Commission's request during the evidentiary hearing in the dockets referenced above, attached please find two late-filed exhibits submitted on behalf of the Public Staff for filing in the above-captioned dockets. Public Staff Late-Filed Exhibit No. 4, prepared by Michael Maness, provides the Public Staff added Asset Retirement Obligation accounting entries (bolded and underlined) to DEP's Late Filed Exhibit 24, filed November 23, 2020. Public Staff Late-Filed Exhibit No. 5, also prepared by Michael Maness, discusses prior Commission decisions denying cost deferral in situations similar to those present in these dockets.

By copy of this letter, we are forwarding copies to all parties of record.

Sincerely,

s/ Dianna W. Downey
Chief Counsel
dianna.downey@psncuc.nc.gov

s/ Reita D. Coxton
Staff Attorney
reita.coxton@psncuc.nc.gov

Attachment

Executive Director	Accounting	Consumer Services	Economic Research
(919) 733-2435	(919) 733-4279	(919) 733-9277	(919) 733-2267
Energy	Legal	Transportation	Water/Telephone
(919) 733-2267	(919) 733-6110	(919) 733-7766	(919) 733-5610

4326 Mail Service Center • Raleigh, North Carolina 27699-4300 • Fax (919) 733-9565
An Equal Opportunity / Affirmative Action Employer

<u>THIS PUBLIC STAFF LATE-FILED EXHIBIT IS AN ADAPTATION OF DEP'S LATE-FILED EXHIBIT NO. 24, FILED NOVEMBER 23, 2020, WITH PUBLIC STAFF ADDITIONS BOLDED AND UNDERLINED.</u>

Duke Energy Progress, LLC
Docket No. E-2, Sub 1219
Late Filed Exhibit #24 - ARO Accounting Entries

<u>Background:</u>

This Late Filed Exhibit describes the life-cycle of asset retirement obligations from establishment through recovery, and the associated accounting entries. The described accounting treatment is consistent with DEP's accounting practices in place since the enactment of state and federal laws related to coal ash remediation. These practices were described in detail in the letter dated December 21, 2015 from Brian D. Savoy to the Commission (the "Savoy Letter" (DEP Exhibit No. 26)). The Savoy Letter was also filed in Docket No. E-2, Sub 1103, which was ultimately consolidated into the previous rate case (Docket No. E-2, Sub 1142). The accounting treatment described in the Savoy Letter is also consistent with the testimony filed and given in the current rate case (Docket No. E-2, Sub 1219) by witnesses Sean Riley and David Doss.

<u>Period 1: Legal obligation imposed</u>

An Asset Retirement Obligation (ARO) is recorded when an entity has a legal obligation associated with the retirement of a tangible asset. In the case of the coal ash basins operated by DEP, the requirement to establish AROs was triggered by the legal obligation, set forth in CAMA and the CCR Rule, to close the basins. GAAP and FERC accounting rules require that when the legal obligation is imposed, a liability and a corresponding asset are recorded. The amount initially recorded represents the present value of the expected future spend that will be required to settle the obligation. The asset retirement cost (ARC) asset is recorded as part of the property, plant and equipment costs of the related asset. In the case of coal ash ARO's, the costs are recorded as part of the cost of the related coal plant. **<u>For NCUC North Carolina retail accounting and ratemaking purposes, neither the ARC asset recorded in Account 101 nor the ARO liability recorded in Account 230 are included in rate base at any time between initial recording and settlement/retirement.</u>**

<u>Period 2: Remaining life of the related asset</u>

The ARC asset is depreciated straight-line over the remaining life of the related coal plant. Since the ARO liability was recorded at present value, it is accreted, or increased, each year to account for the time value of money, so that the liability will be sufficient to provide for the expected cash outlays associated with the ash basin closure activities when they occur, which may be at or several years after the date the related coal plant is retired. The depreciation and accretion are initially recorded as expense on the entity's financial statements; however, in accordance with the Order in Docket No. E-2, Sub 826, DEP defers the income statement impacts of ARO accounting to a regulatory asset until such time that the amounts are considered for recovery from rate payers. **<u>[NOTE - The Public Staff considers the Order(s) in Docket No. E-2, Subs 1103 and 1142, to be controlling for purposes of deferral approval, not the Order in Sub 826.]</u>** Throughout the remaining life of the related asset, the ARO liability estimates are reviewed and remeasured as needed to reflect changes in assumptions of the total amount that will be needed to settle the obligation. These deferred amounts are estimated costs to settle the ARO liability and do not represent actual cash spent to settle the obligation. These amounts are deferred to a "theory" regulatory asset account representing the estimated amount to settle the ARO. The Company does not seek recovery of amounts recorded to the "theory" regulatory asset, since those amounts are non-cash. In addition, being non-cash, the ARC asset and the ARO liability balances, as well as the "theory" regulatory asset account, do not represent amounts advanced either by investors – e.g., in order to fund actual spend by the Company – or by customers. As such, these amounts are not included in rate base, either as an addition to rate base in the case of investor funding, or an offset to rate base in the case of customer funding.

<u>Period 3: Settlement of the ARO liability</u>

As cash is spent to settle the ARO, DEP reclasses that amount out of the "theory" regulatory asset into a separate "spend" regulatory asset account that represents actual cash expenditures. Since the costs have yet to be included in customer rates, the cash spent to settle the ARO has been advanced by debt and equity investors of the Company and therefore financing costs (debt and equity) are also deferred to the "spend" regulatory asset based on the Company's weighted average cost of capital "WACC".

<u>Period 4: Recovery period</u>

The Company seeks recovery of the "spend" regulatory asset and will receive an amortization period for recovery (i.e. 5 year amortization period was approved in the last rate case for the amounts included for recovery in that case). Additionally, as approved in the last rate case, financing charges continue to accrue on the un-amortized balance during the recovery period because the un-amortized balance represents amounts advanced by debt and equity investors but not yet recovered from customers. Ultimately, only amounts actually spent to settle the ARO and associated financing costs for cash advanced by debt and equity investors are sought for recovery from customers. **<u>The Public Staff opposes the recovery of financing charges during the recovery period (through rate base inclusion) from ratepayers.</u>**

Below is an example of the basic accounting entries recorded for AROs. The assumptions used for this example are as detailed below:

<u>Assumptions:</u>

- Estimated cost to settle ARO in the future is $1,050.
- Present Value of estimated spend is $1,000 at date ARO established.
- For this simplified example, actual spend equals estimated spend. In reality, as noted above, liability estimates would be re-measured periodically throughout the life of the asset.
- Spend and recovery period are assumed to be 1 year **<u>and 5 years, respectively,</u>** in this example.
- For ease of illustration, this example does not show the effect of income taxes.

		Debit (Credit)										
	Note 1	Balance Sheet							Income Statement			
		Cash	101 Electric Plant in Service	108 Accumulated Depreciation	182.3 Regulatory Assets "theory"	182.3 Regulatory Assets "spend"	230 Asset Retirement Obligation		400 Revenue	403.1 Depreciation Expense	411.10 Accretion Expense	407 Amortization Expense
Period 1: Legal obligation imposed												
Recognize creation of the ARO liability and corresponding ARC asset at present value of expected future spend	Note 1		1,000				(1,000)					
Period 2: Remaining life of the related asset												
Accretion of the ARO liability over remaining life of related asset	Note 1; Note 2						(50)				50	
Depreciation of the ARC asset over remaining life of related asset	Note 1; Note 2			(1,000)						1,000		
Regulatory deferral of accretion and depreciation expense	Note 3				1,050					(1,000)	(50)	
Balance prior to settlement of ARO liability		0	1,000	(1,000)	1,050	0	(1,050)		0	0	0	0
Period 3: Settlement of ARO liability (cash expenditure)	Note 4											
Cash spent to settle liability	Note 1	(1,050)					1,050					
Reclass cash expenditures to "spend" regulatory asset for recovery **(Inclusion in rate base opposed by Public Staff in this proceeding)**	Note 5				(1,050)	1,050						
Financing costs (debt and equity) for cash expenditures during the deferral period	Note 6	(105)				105						
Balance for recovery, before adding financing costs during recovery period		(1,155)	1,000	(1,000)	0	1,155	0		0	0	0	0
Period 4: Recovery period												
Recovery of regulatory asset over approved amortization period		1,155				(1,155)			(1,155)			1,155
Recovery of financing costs (debt and equity) for the regulatory asset during **assumed 5-year** recovery period **(opposed by Public Staff)**	Note 7	**347**							**(347)**			

Note 1 - As it relates to ARO accounting, the only amounts included in rate base **for NCUC N.C. retail rate base for regulatory accounting and ratemaking purposes** are the actual cash expenditures and financing costs recorded to the 182.3 "spend" regulatory asset once amounts have been approved for recovery.

Note 2 - Depreciate straight-line over remaining life of related asset. If asset/plant is already retired, depreciate full value of ARC asset immediately after recording the entry in Period 1 above. **The net operating income impact of the depreciation and accretion expense entries are immediately eliminated through deferral.**

Note 3 - Defer income statement impacts based on Order from Docket No. E-2, Sub 826. **The balance of "Regulatory Assets 'theory'" is not proposed for inclusion in NCUC rate base by Company.**

Note 4 - Immaterial cost of removal (COR) collections received from customers from July 1, 2012 to March 15, 2018, related to coal ash sites, were applied as a reduction to incurred spend, recorded in the spend regulatory asset. For simplicity, the entry is not shown in the example.

Note 5 - Reclass **from the "theory" regulatory asset** to a spend regulatory asset based on Order from Docket No. E-2, Sub 1142. **(This reclass occurs over time as cash is spent; it is not timed to, and almost certainly does not by coincidence match the contemporaneous deferral of accretion and depreciation expense recorded above.)**

Note 6 - Cash has been advanced by debt and equity investors. This example assumes the financing costs at a weighted average cost of capital (WACC) of 10% **for one year**. The associated financing costs are deferred during the recovery period to the "spend" regulatory asset.

Note 7 - Represents the revenue requirement associated with the debt and equity financing costs (assumed to be at a WACC of 10%) for the unamortized balance during the **assumed five-year** recovery period.

Public Staff Late Filed Exhibit No. 5

Docket Nos. E-2, Sub 1193, and E-2, Sub 1219

On Monday, September 14, 2020, during the Duke Energy Progress, LLC (DEP) evidentiary hearing in the above-captioned dockets, the panel of Public Staff witnesses Jay B. Lucas and Michael C. Maness was asked by Commissioner Kimberly W. Duffley to provide requested prior Commission decisions, if any, denying cost deferral for other types of deferral requests described by witness Maness as being more similar to the deferral of non-Asset Retirement Obligation (ARO) coal combustion residual (CCR) costs. In addition, Commissioner Duffley asked the Public Staff to confirm whether this issue was settled between the Public Staff and DEP in the Second Agreement and Stipulation of Partial Settlement. In response, the Public Staff respectfully offers the following:

Proposed Treatment of Non-ARO CCR Costs in Future Proceedings

In the current proceeding, the Public Staff did not object to the deferral of non-ARO CCR costs incurred through February 29, 2020, with carrying costs through August 31, 2020. However, the Public Staff and DEP did not settle the issue of whether deferral of non-ARO CCR costs incurred after February 29, 2020 should be "automatically" allowed for deferral pursuant to the Commission's Orders in Docket No. E-2, Subs 1103 and 1142.

Dominion Energy North Carolina Requested Deferral of Warren County Combined Cycle Facility Costs

On March 29, 2016, in Docket No. E-22, Sub 519, the Commission issued an *Order Denying Deferral Accounting for Warren County Combined Cycle Generating Facility* (Sub 519 Order). In the Sub 519 Order, the Commission denied the application of Virginia Electric and Power Company d/b/a Dominion North Carolina Power [now d/b/a Dominion Energy North Carolina (DENC)] to defer capital and operating costs of the Warren County combined cycle generating facility (Warren County CC). The specific costs for which deferral was requested were the post-in-service financing costs, depreciation expense, property taxes, and non-fuel operation and maintenance (O&M) expenses incurred between December 10, 2014 (the facility's in-service date) and June 30, 2016 (the expected effective date of DENC's expected next general rate case). In the Sub 519 Order, the Commission set forth several reasons for its denial, including, perhaps most importantly, the fact that DENC's "reasonably expected" return on equity (ROE) in the timeframe in which the Warren County CC was placed in service (after consideration of several adjustments recommended by the Public Staff) was "well above" the 10.20% ROE then most recently authorized by the Commission (in DENC's general rate case in Docket No. E-22, Sub 479), even when taking into consideration the pro forma financial impacts of placing the Warren County CC in service.

On March 29, 2016, DENC filed for reconsideration of the Commission's Sub 519 Order, and, on May 17, 2016, the Commission issued an order consolidating the motion for reconsideration with DENC's then-pending general rate case application, Docket No. E-22, Sub 532 (Sub 532), which had been filed with the Commission on March 1, 2016.

In Sub 532, the Public Staff reversed its opposition to the deferral of post-in-service costs of the Warren County CC. Public Staff witness Katherine A. Fernald testified in the proceeding that DENC had filed additional information regarding its earnings calculations in the relevant time period, information that, had it been known by the Public Staff at the time of the original deferral request, would have changed the Public Staff's opinion regarding the appropriateness of the deferral, due to it causing the reasonably expected ROE to fall substantially below DENC's authorized ROE. The Public Staff thus reached a stipulation with DENC that provided for the approval of the deferral.

In its *Order Approving Rate Increase and Cost Deferrals and Revising PJM Regulatory Conditions* (Sub 532 Order), issued on December 22, 2016, the Commission approved the deferral of the applicable post-in-service costs of the Warren County CC.

<u>Carolina Water Service's Request to Defer the Post-In-Service Costs of its Automated Meter Reading (AMR) Meters Projects</u>

On June 28, 2019, Carolina Water Service, Inc. of North Carolina (CWSNC) filed a *Petition for an Accounting Order to Defer Post-In-Service Depreciation and Financing Costs Relating to Major New Projects* (Sub 365 Petition), requesting authority to defer incremental post-in-service depreciation expenses and financing costs associated with four new projects that were projected to be in-service prior to the effective date of rates to be set in CWSNC's then newly-pending general rate case, Docket No. W-354, Sub 364 (Sub 364). Two of these projects were the Connestee Falls Automated Meter Reading (AMR) Meters project and the Fairfield Mountain Automated Meter Reading (AMR) Meters project (collectively, the AMR Projects). The AMR Projects involved the installation of approximately 2,529 new AMR meters. On November 19, 2019, the Commission issued an order consolidating Sub 365 with Sub 364.

In its comments filed in Sub 365, and thus in the Sub 364 general rate case proceeding, the Public Staff opposed the deferral of the costs of the AMR Projects. The basis for the Public Staff's opposition was its assertion that CWSNC had failed to make a clear, complete, and convincing showing, in view of the entire record, that the costs of the AMR meters were of an unusual or extraordinary nature and, absent deferral, would have a material impact on the Company's financial condition. More specifically, the Public Staff asserted that meter replacement of any kind should not be considered extraordinary or unusual, but instead routine.

On March 31, 2020, the Commission issued its *Order Granting Partial Rate Increase and Requiring Customer Notice* in Sub 364 (Sub 364 Order). In the Sub 364 Order, the Commission concluded that it agreed with the Public Staff's position and reasoning, and denied deferral of the costs of the AMR Projects.[1]

[1] Although it denied deferral accounting treatment, the Commission did state that CWSNC and the Public Staff should work together to mitigate regulatory lag using the Water System Improvement Charge (WSIC) recovery process.