STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 1146
DOCKET NO. E-7, SUB 819
DOCKET NO. E-7, SUB 1110
DOCKET NO. E-7, SUB 1152

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-7, SUB 1146 In the Matter of Application of Duke Energy Carolinas, LLC for Adjustment of Rates and Charges Applicable to Electric Utility Service in North Carolina DOCKET NO. E-7, SUB 819 In the Matter of Amended Application by Duke Energy Carolinas, LLC, for Approval of Decision to Incur Nuclear Generation Project Development Costs 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 DOCKET NO. E-7, SUB 1152 In the Matter of Application of Duke Energy Carolinas, LLC for Order Approving a Job Retention Rider	TECH CUSTOMERS PARTIAL PROPOSED ORDER GRANTING RATE INCREASE

HEARD: Tuesday, January 16, 2018, at 7:00 p.m., Macon County Courthouse, 5 W. Main Street, Courtroom A, Franklin, North Carolina.

Wednesday, January 24, 2018, at 7:00 p.m., Guilford County Courthouse, 201 S. Eugene Street, Courtroom 1C, Greensboro, North Carolina.

Tuesday, January 30, 2018, at 6:30 p.m., Mecklenburg County Courthouse, 832 E. 4th Street, Charlotte, North Carolina.

Monday, March 5, 2018, at 1:30 p.m., Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina.

BEFORE: Chairman Edward S. Finley, Jr., Presiding; Commissioners ToNola D. Brown-Bland, Jerry C. Dockham, James G. Patterson, Lyons Gray, and Daniel G. Clodfelter.

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BY THE COMMISSION: On August 25, 2017, Duke Energy Carolinas, LLC (DEC or the Company) filed an Application to Adjust Retail Rates and Request for Accounting Order (Application), along with a Rate Case Information Report Commission Form E-1 (Form E-1), and the direct testimony and exhibits of David B. Fountain, President, DEC; Jane L. McManeus, Director of Rates and Regulatory Planning, DEC; Scott L. Batson, Senior Vice President of Nuclear Operations, Duke Energy Corporation (Duke Energy);[1] Stephen G. De May, Senior Vice President of Tax and Treasurer, Duke Energy Business Services, LLC (DEBS);[2] David L. Doss, Jr., Director of Electric Utilities and Infrastructure Accounting, DEBS; Christopher M. Fallon, Vice President of Duke Energy Renewables and Commercial Portfolio, Duke Energy; Janice Hager, President, Janice Hager Consulting; Robert B. Hevert, Partner, ScottMadden, Inc.; Retha Hunsicker, Vice President of Customer

[1] DEC is a wholly-owned subsidiary of Duke Energy Corporation.

[2] DEBS provides various administrative and other services to DEC and other affiliated companies of Duke Energy.

Information Systems - Customer Operations, DEBS; Jon F. Kerin, Vice President of Governance and Operations Support – Coal Combustion Products, DEBS; Julius A. Wright, Managing Partner, J.A. Wright & Associates, LLC; Kimberly D. McGee, Rates and Regulatory Strategy Manager, Duke Energy Progress, LLC (DEP) and DEC; Joseph A. Miller, Jr., Vice President of Central Services, DEBS; Robert M. Simpson, III, Director of Grid Improvement Plan Integration for Duke Energy's Regulated Utilities Operations, DEP; Michael J. Pirro, Manager, Southeast Pricing and Regulatory Solutions for DEC, DEP and Duke Energy Florida, LLP; James H. Cowling, Director, Outdoor Lighting, DEC; Donald L. Schneider, Jr., General Manger, Advanced Metering Infrastructure Program Management, DEBs; and Nils J. Diaz, Ph.D., Managing Director, ND2 Group, LLC.

Petitions to intervene were filed by NCSEA on July 25, 2017; CIGFUR on August 8, 2017; CUCA on August 9, 2017; Rate-Paying Neighbors on August 23, 2017; EDF on August 25, 2017; NCFB on September 6, 2017; NC WARN on September 7, 2017; the Sierra Club on September 18, 2017; Kroger on September 19, 2017; NCLM on October 3, 2017; Blue Ridge EMC, Haywood EMC, Rutherford EMC, and Piedmont EMC on October 16, 2017; Commercial Group on October 31, 2017; Apple Inc., Facebook, Inc., and Google LLC (Tech Customers) on November 2, 2017; the Cities of Concord and Kings Mountain on November 17, 2017; NC Justice Center on December 19, 2017; City of Durham on January 3, 2018; and ASU on September 29, 2017. Notice of Intervention was filed by the Attorney General on August 31, 2017.

The Commission entered Orders granting the petitions to intervene of NCSEA on August 7, 2017; EDF on September 5, 2017; CUCA on September 18, 2017; CIGFUR on September 19, 2017; Rate-Paying Neighbors on September 19, 2017; NCFB on September 19, 2017; NC WARN on September 15, 2017; the Sierra Club on September 28, 2017; Kroger on September 28, 2017; NCLM on October 4, 2017; and ASU on October 19, 2017; Blue Ridge EMC, Haywood EMC, Rutherford EMC, and Piedmont EMC on October 20, 2017; Tech Customers on November 8, 2017; Commercial Group on November 8, 2017; the Cities of Concord and Kings Mountain on December 14, 2017; NC Justice Center on January 11, 2018; and City of Durham on January11, 2018.

The Public Staff's intervention is recognized pursuant to G.S. 62-15(d) and Commission Rule R1-19. The intervention of the Attorney General's Office (AGO) is recognized pursuant to G.S. 62-20.

On September 19, 2017, the Commission issued its Order Establishing General Rate Case and Suspending Rates. On October 13, 2017, the Commission issued its Order Scheduling Investigation and Hearings, Establishing Intervention and Testimony Due Dates and Discovery Guidelines, and Requiring Public Notice.

On October 18, 2017, the Commission issued an Order consolidating Docket No. E-7, Sub 1146 with Docket No. E-7, Sub 819 (DEC's request for approval of decision to incur nuclear generation project development costs and request for approval to cancel) and Docket E-7, Sub 1152 (DEC's request for approval of a job retention rider), and allowing those persons who had been granted intervention in those dockets to fully participate in this proceeding.

On October 20, 2017, the Commission issued its Amended Order Scheduling Investigation and Hearings, Establishing Intervention and Testimony Due Dates and Discovery Guidelines, and Requiring Public Notice, revising the deadlines for discovery requests and for intervenors to submit direct testimony.

On December 15, 2017, DEC filed supplemental testimony and exhibits by Company Witness McManeus and on December 18, 2017, filed revised supplemental testimony and exhibits by witness McManeus. On January 16, 2018, DEC filed a second supplemental testimony and exhibits of Company witness McManeus. On January 18, 2018, EDF filed testimony by Paul J. Alvarez, President, Wired Group. On January 23, 2018, Public Staff filed the testimony and exhibits of James S. McLawhorn, Director, Electric Division, Jay B. Lucas, Utilities Engineer, Electric Division, Scott J. Saillor, Utilities Engineer, Electric Division, Tommy C. Williamson, Jr., Utilities Engineer, Electric Division, Charles Junis, Utilities Engineer, Communications Division, Jack L. Floyd, Utilities Engineer, Electric Division, Dustin R. Metz, Utilities Engineer, Electric Division, Michael C. Maness, Director, Accounting Division, Michelle M. Boswell, Staff Accountant, Electric Section, Accounting Division, John R. Hinton, Director, Economic Research Division, Vance F. Moore, President of Garrett and Moore, Inc., L. Bernard Garrett, Secretary/Treasurer of Garrett and Moore, Inc., David C. Parcell, Principal and Senior Economist of Technical Associates, Inc., and Roxie McCullar, Consultant, William Dunkel and Associates; CUCA filed the direct testimony and exhibits of Kevin W. O'Donnell, President, Nova Energy Consultants, Inc.; Tech Customers filed direct testimony and exhibits of Kurt G. Strunk, Director of National Economic Research Associates ("NERA"), and Edward D. Kee, Affiliated Expert with NERA Economic Consulting and CEO of Nuclear Economics Consulting Group; Kroger filed testimony of Kevin C. Higgins, Principal in the firm Energy Strategies, LLC; NC Justice Center filed the direct testimony and exhibits of Jonathan Wallach, Vice President, Resource Insight, Inc., and Satana Deberry, Executive Director, NC Housing Coalition; Sierra Club filed the direct testimony and exhibits of Ezra D. Hausman, consultant, Ezra Hausman Consulting, and Mark Quarles, principle scientist and owner, Global Environmental, LLC; NCLM filed the direct testimony of F. Hardin Watkins, Jr., City Manager for the City of Burlington, Brian Coughlan, President of Utility Management Services, Inc., Maria Hunnicutt, General Manager for the Broad River Water Authority, and Adam Fischer, Transportation Director for the City of Greensboro; CIGFUR filed the direct testimony and exhibits of Nicholas Phillips, Jr., public utility regulation consultant and a Managing Principal of Brubaker & Associates, Inc.; the Attorney General's Office filed the testimony and exhibits of J. Randall Woolridge, Ph.D., Professor of Finance and the Goldman, Sachs &Co. and Frank P. Smeal Endowed University Fellow in Business Administration at the University Park Campus of the Pennsylvania State University, and Dan J. Wittliff, Managing Director of Environmental Services for GDS Associates, Inc.; NCSEA filed the direct testimony and exhibits of Michael Murray, President, Mission:data Coalition, Justin R. Barnes, Director of Research, EQ Research, LLC, and Carolina Golin, Southeast Regulatory Director, Vote Solar; and Commercial Group filed the direct testimony and exhibits of Steve W. Chriss, Director, Energy and Strategy Analysis, Wal-Mart Stores, Inc., and Wayne Rosa, Energy and Maintenance Manager, Food Lion, LLC.

On January 31, 2018, NCSEA filed a correction to the testimony of witness Golin.

On February 6, 2018, DEC filed the rebuttal testimony and exhibits of Company witnesses Fountain, McManeus, Cowling, De May, Doss, Diaz, Fallon, Hager, Hevert, Hunsicker, Kerin, McGee, Miller, Pirro, Schneider, Thomas Silinski, Vice President of Total Rewards and Human Resource Operations, DEBS, Simpson, James Wells, Vice President of Environmental Health and Safety - Coal Combustion Products, DEBS, and Wright; and external expert witnesses John J. Spanos, Senior Vice President, Gannet Fleming Valuation and Rate Consultants, LLC; and Jeffrey T. Kopp, Manager of Business Consulting Department – Business and Technology Services Division, Burns and McDonnell Engineering Company, Inc.

On February 16, 2018, the Commission issued its Order on Hearing Procedure and Availability of Witnesses.

On February 20, 2018, Public Staff filed supplemental testimony of witnesses Maness, Boswell, Hinton, Moore, Saillor, and Junis.

On February 23, 2018, the Commission issued an Order Rescheduling Hearing to postpone the hearing scheduled to begin on February 27, 2018, to March 5, 2018.

On February 28, 2018, DEC and the Public Staff filed an Agreement and Stipulation of Partial Settlement (Stipulation) that resolved all issues between DEC and the Public Staff, with the exception of: (1) cost recovery of DEC's CCR costs, recovery amortization period and return during the amortization period, allocation issues associated with CCR costs, ongoing costs to be included in rates, and whether certain CCR costs are recoverable under G.S. 62-133.2; (2) whether it is appropriate to allow a return on the unamortized balance during the amortization period relating to recovery of Lee Nuclear costs; (3) with respect to DEC's proposed Job Retention Rider (JRR), whether companies involved in the transportation or preservation of raw material or a finished product should qualify, and how, or if, the JRR should be funded after the expiration of the initial year's $4.5 million shareholder contribution; (4) the status of DEC's Nuclear Decommissioning Trust Fund and the Public Staff's proposal to adjust nuclear decommissioning expense; (5) the final update month to be used for ratemaking and what should be included in the update; (6) the methodology for calculating customer usage through December 2017; (7) the manner in which the Federal Tax Cuts and Jobs Act (FTCJA) should be addressed in this case; (8) the amount of annual depreciation expense and associated accumulated depreciation to be used for ratemaking in this case; (9) whether a Grid Reliability and Resiliency (GRR) Rider should be adopted in this proceeding and, if so, which costs should be included in the GRR Rider and the structure of the GRR Rider; (10) the amount of the Basic Facilities Charge; and (11) any other revenue requirement or non-revenue requirement issue other than those specifically addressed in the Stipulation or agreed upon in the testimony of the Stipulating Parties.

In support of the Stipulation, on March 1, 2018, the Public Staff filed the settlement testimony and exhibits of witnesses Boswell, Maness, and Parcell. Also on this date, DEC filed the settlement testimony and exhibits of Company witnesses Fountain, Hevert, De May, McManeus, and Pirro.

On February 28, 2018, DEC and the North Carolina League of Municipalities, the City of Concord, and the City of Kings Mountain filed a Partial Settlement Agreement resolving certain specified issues between them in this docket. The parties filed an Amended Settlement Agreement on March 2, 2018, in which they revised certain settlement language and added the City of Durham as a party to the settlement.

On March 2, 2018, DEC filed a Revised Stipulation Exhibit 1 of McManeus and Settlement Exhibit 5 of Pirro.

The public hearings were held as scheduled and various public witnesses offered testimony concerning the matters in this docket.

This matter came on for the expert witness hearing on March 5, 2018. DEC presented the testimony of Company witnesses Fountain, McManeus, Hevert, De May, Simpson, Hunsicker, Miller, Doss, Hager, Fallon, Spanos, Kopp, Schneider, Pirro, Wright, Wells, and Kerin. The Public Staff presented the testimony of witnesses McLawhorn, Moore, Hinton, Garrett, Maness, and Floyd. The Attorney General presented the testimony of witnesses Woolridge and Wittliff. Sierra Club presented the testimony of witness Quarles. NC Justice Center presented the testimony of witnesses DeBerry, Howat, and Wallach. NCSEA presented the testimony of witnesses Golin and Barnes. CUCA presented the testimony of witness O'Donnell. Kroger presented the testimony of witness Higgins. Tech Customers presented the testimony of witness Kee. NCLM presented the testimony of witness Coughlan. Parties waived cross-examination of Company witnesses Batson, Cowling, Diaz, McGee, Miller, and Silinski; NCSEA witness Murray; NCLM witnesses Watkins, Hunnicutt, and Fischer; Tech Customers witnesses Strunk and Brown-Hruska; EDF witness Alvarez; CIGFUR witness Phillips; Sierra Club witness Hausman; Commercial Group witnesses Chriss and Rosa; and Public Staff witnesses Boswell, Junis, Lucas, McCullar, Parcell, and

Saillor. The pre-filed testimony of each of these witnesses was copied into the record as if given orally from the stand and their exhibits entered into evidence.

On March 9, 2018, the Attorney General's office filed supplemental testimony of witness Woolridge. On March 20, 2018, the Public Staff filed a second supplemental testimony of witness Hinton.

On March 19, 2018, Public Staff filed second supplemental testimony and exhibits of witnesses Boswell and Hinton.

On March 20, 2018, Tech Customers filed supplemental testimony of witness Strunk and Dr. Sharon Brown-Hruska, Managing Director of NERA.

DEC filed late-filed exhibits on March 28, 2018 (Exhibit of Current Allowance for Funds Used During Construction and Current After-Tax), April 2, 2018 (Power/Forward Late Filed Exhibit), April 6, 2018 (Exhibit Regarding Planned Change to Minimum System Study Methodology) and April 24, 2018 (Exhibit Regarding Atlantic Coast Pipeline), in response to the Commission's questions and orders.

On April 5, 2018, Public Staff filed the late-filed Exhibit 20 of witness Junis.

On April 18, 2018, the Attorney General's Office filed a late-filed exhibit, which was approved by Order of the Commission on April 24, 2018.

On April 27, 2018, proposed orders and briefs were filed by the parties and intervenors.

Based upon consideration of the pleadings, testimony, and exhibits received into evidence at the hearings, the Stipulations, and the record as a whole, the Commission makes the following:

FINDINGS OF FACT

Grid Reliability and Resiliency Rider

1. The Company's proposed GRR Rider is intended to serve as a vehicle for funding investments in various projects under the broad umbrella of "grid modernization" over a projected ten-year period. The total projected statewide expenditures amount to approximately $13 billion over the life of the project.

2. The Company has not provided compelling evidence that the proposed grid investment plan will result in meaningful benefits to ratepayers that outweigh its considerable cost. The Commission concludes that DEC has not shown that the proposed Power/Forward investments are reasonable or prudent,

that the GRR Rider is necessary to make such investments, or that the proposed rider would be in the public interest.

3. The North Carolina General Assembly has not authorized adoption by this Commission of a rate rider to fund the investments comprising the Power/Forward initiative. While the Commission has certain authority to adopt riders in connection with a general rate case, the Commission has not previously adopted a rider of the nature and magnitude sought by the Company here.

Federal Income Tax Changes

4. The Commission is required in this general rate case to, among other things, account for the Company's operating expenses for the test year, taking into account "evidence . . . tending to show actual changes in costs". *See, e.g.,* G.S. § 62-133(b)(3) and (c). Given this requirement, the effects of the Federal Tax Cuts and Jobs Act of 2017 ("FTCJA") as to the rates charged by the Company should be addressed in this general rate case rather than the separate, generic proceeding that the Commission has initiated in Docket No. M-100, Sub 148.

5. The amounts collected from ratepayers to defray DEC's tax obligations should be calculated based on the federal income tax rate established by the FTCJA.

6. Excess Deferred Income Taxes ("EDIT") represent amounts collected from ratepayers and held by DEC in excess of future tax liabilities. EDIT associated with DEC's federal income tax obligations should be returned to ratepayers in accordance with the normalization rules of the Internal Revenue Service ("IRS") or, as proposed by the Public Staff, over five years through a levelized rider.

7. The Public Staff's proposal for return of EDIT best balances the need to return tax overcollections to ratepayers as promptly as possible with the appropriate regulatory goals of avoiding adverse rate impacts for ratepayers and allowing sufficient time for DEC to manage its cash flow so as to avoid negative impacts to its credit metrics.

8. DEC's proposal to offset the reduction in its revenue requirement resulting from the FTCJA with $200 million in accelerated depreciation expense is not sufficiently supported in the record and raises significant legal and practical concerns. A decline in revenues resulting from a change in federal tax law does not, by itself, support the adopting of offsetting revenue increases where those increases are not independently justified and supported.

<u>Lee Nuclear Station</u>

9. DEC seeks approval by the Commission of the Company's decision to cancel the Lee Nuclear project. It also seek recovery of the production development costs incurred in connection with the Lee Nuclear project, amortized over 12 years, plus a return on the unamortized portion.

10. The Company's decision to abandon construction of the Lee Nuclear Project is sufficiently explained in its Request for Approval to Cancel the Lee Nuclear Project filed on August 25, 2017, in Docket E-7, Sub 819. The Commission has no reason to second-guess the determinations made by the Company, nor has any party challenged the Company's determination. Given that the Commission has not authorized construction of the project, there is no legal requirement that the Company seek prior approval to abandon the project nor is there a legal requirement that this Commission review or approve such a decision.

11. The Company should be permitted to recover its costs associated with development of the Lee Nuclear Project subject to the following adjustments:

- DEC should only be allowed to recover the North Carolina allocable share of its actual costs, including AFUDC, incurred in the period up to December 31, 2009, if those actual costs are less than the not-to-exceed limits in the 2007 Order and the 2008 Order. Based upon the evidence in the record, this is the North Carolina allocable share of $172,002,979, including AFUDC.

- DEC should only be allowed to recover costs of the Lee Nuclear project after January 1, 2011, to the extent those costs were clearly required to maintain the status quo and they did not exceed the not-to-exceed cap of the North Carolina allocable share of $120 million, including AFUDC. Given DEC's failure to submit evidence that would allow the Commission to verify "status quo" expenditures, the Commission concludes that it is appropriate to deny recovery for costs incurred during this period as there is no basis for concluding that such costs were reasonably and prudently incurred.[3]

- DEC should not be permitted to recover AFUDC on is costs after August 5, 2011, the date of the Commission's last project development costs order in Docket No. E-7, Sub 819, when the Commission made clear that it was taking DEC at its word that it had no present intent to construct Lee.

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[3] **[*ALTERNATIVE*]** The Commission concludes that it is appropriate to allow only the costs during this period most closely identified with maintenance of the "status quo," which is the North Carolina allocable share of $73,111,397, without AFUDC.

- DEC's costs incurred in 2010 were denied in the 2011 Order and, therefore, are not recoverable.

Return on Equity

12. In his testimony on behalf of the Company, witness Hevert recommends approval of a return on equity ("ROE") of 10.75%, representing an increase from DEC's current authorized ROE of 10.2%.

13. In their Stipulation, DEC and the Public Staff agree that the Commission should approve a ROE of 9.9%, along with an embedded cost of debt of 4.49% and a capital structure consisting of 48% long-term debt and 52% members' equity.

14. While the Stipulation is material evidence entitled to appropriate weight in determining DEC's ROE and other rate of return inputs, the ROE approved by the Commission must be justified by substantial, competent evidence from the record as a whole.

15. A utility advocating an ROE figure that substantially exceeds the output of widely recognized empirical models and that also exceeds recently authorized ROEs must justify that proposed upward departure with a quantitative analysis that shows the applicant's risk profile to be materially higher than that of the proxy group. Here, the Company has failed to support with empirical analysis either the return on equity figure sought in its application or the return on equity to which it stipulated with the Public Staff.

16. Although the ROE agreed to by the Stipulation Parties is comfortably within the range advocated by the parties to the Stipulation, the Stipulation, standing alone, cannot support the recommended ROE, particularly when the rate at one side of the range lacks any objective indicia of a rational basis. The mathematical convenience of the stipulated rate is insufficient justification, standing alone, for its adoption.

17. Given the results of the empirical models and the lack of objective evidence offered by DEC that DEC presents a higher risk profile than the peer group warranting an upward departure from these measures, the Stipulated ROE of 9.9% is unreasonably high. Accordingly, the evidence presented concerning other authorized rates of return on equity, when put into proper context, lends substantial support to an authorized rate of return on equity of 9.70%.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-3
[GRR RIDER]

The evidence supporting this finding of fact and conclusions is contained in the testimony of DEC witnesses Fountain, McManeus, and Simpson; Public Staff witnesses Williamson and Maness; CUCA witness O'Donnell; EDF witness

Alvarez; Kroger witness Higgins; CIGFUR III witness Phillips; NCSEA witness Golin; Tech Customers witness Strunk, and the entire record in this proceeding.

Company witness Fountain testified regarding the $13 billion grid modernization plan for DEP and DEC over the next decade in North Carolina, which has been named Power/Forward Carolinas (Power/Forward). (Tr. Vol. 6, p. 192.) He testified that the purpose of this plan is to improve the performance and capacity of the grid, making it smarter and more resilient and providing customers greater benefit. (Id.) Power/Forward investment is planned to supplement $4.5 billion of customary spend over the same period. (Id.) To pay for this initiative, DEC proposes to implement a Grid Reliability and Resiliency ("GRR") Rider to "align . . . grid investments . . . with the timeliness of recovery for these investments." (Id. at 193.) The GRR Rider "would be reset annually based on actual costs, with a true up for any over- or under-recovery." (Id.) In rebuttal testimony, Witness Fountain also cited a study by Ernst and Young, which shows various direct and indirect economic benefits that are projected to result from the planned Power/Forward investments. (Id. at 211.)

On cross-examination, witness Fountain testified that DEC did not submit direct testimony regarding the rate impact of the proposed GRR Rider, (Tr. Vol. 6, p. 430), although he later testified that the net average retail impact would be a 16 percent increase over the next decade, (Tr. Vol. 7, pp. 55-56, 90-91), with a higher impact on residential rates, (Tr. Vol. 9, pp. 26-27). He also testified that DEC does not contend it will not make the investments without approval of the rider. (Tr. Vol. 6, p. 430.) Rather, DEC probably would make the same investments, but would do it over a longer period of time. (Tr. Vol. 9, pp. 51-54; Tr. Vol. 10, pp. 45-46.) Witness Fountain conceded that electricity demand growth is currently "not as much as in prior decades," (Tr. Vol. 6, at 432), and that the Power/Forward plan is part of Duke Energy's corporate policy intended, as discussed in an earnings call, "to drive 4 to 6 percent earnings growth." (Id. at 434-35.) He also acknowledged that Duke Energy represented to its investors that it would pursue distribution infrastructure riders to enhance investment returns and that the rider's change to the ratemaking regulatory framework is intended to "recover . . . investments in ways that . . . drive shareholder value." (Tr. Vol. 8, pp. 209-10.)

As to the functioning of the GRR Rider mechanism, witness Fountain testified that in the "annual proceeding" DEC "would provide the specific projects that would be reviewed and approved." (Tr. Vol. 9, p. 78.) He further conceded that DEC has made a number of investments, including in nuclear power, and transitioning DEC's grid from analog to digital technology, without the aid of a rider. (Tr. Vol. 10, pp. 44-45.)

Company witness McManeus testified that the GRR Rider will allow DEC to recover the costs of the multi-year, planned Power/Forward system upgrades "on an annual basis as opposed to the traditional method of recovering costs only after project completion through a rate case." (Tr. Vol. 6, p. 270.) She testified that recovering costs in this manner would avoid "dilut[ing] case flow and earnings, which can have the effect of slowing the pace of making the investments." (Id.) The rider would be set based on "a projection of revenue requirements" along with a true-up or "Experience Modification Factor" ("EMF") for a prior test period. (Id. at 271.) The rider would supplement rate changes set in general rate cases, with amounts not recovered under the rider included in base rates during the next rate case proceeding. (Id. at 272.) Witness McManeus testified that DEC was seeking $35.7 million in recovery under the rider for 2018, id., which was subsequently increased to $36.2 million as a result of tax reform. (Id. at 403.) Witness McManeus also requested, in the event the Commission does not approve the rider, the establishment of a regulatory asset to record Power/Forward costs for future recovery in a rate case.

In rebuttal testimony, witness McManeus acknowledged that the GRR Rider would result in an "annual 'mini-rate case'" limited in scope to costs incurred in connection with costs allowed under the rider. (Tr. Vol. 6, p. 333.) She further testified that if, as a result of the rider, DEC's earnings indicated that the Company's rates are not just and reasonable, the Commission could take action. (Id. at 334.) Therefore, she testified, the rider would not "definitively create[] the opportunity for the Company to over earn." (Id.) On cross-examination, witness McManeus acknowledged a number of times that the GRR Rider would pass only costs on to ratepayers, and would not account for cost savings resulting from grid modifications. (Tr. Vol. 6, pp. 439; Tr. Vol. 9, p. 85-87.) She explained that "the reason that the Company requests a rider is to address the issue of regulatory lag that exists in any general rate case proceeding . . . that would have the adverse effect of reducing cash flows and earnings." (Tr. Vol. 6, pp. 440-41.) She also conceded that approval of the GRR Rider would "eliminate some of the regulatory lag" and would mitigate some regulatory risk for DEC. (Tr. Vol. 7, pp. 33-34.) Witness McManeus further testified on cross-examination that the planned spend described in DEC's Power/Forward filings is not granular data at the project level but instead is in "large buckets" corresponding to FERC accounting categories. (Tr. Vol. 9, pp. 74-75.) She testified that Power/Forward pending proposed for 2018 is based on "the same information." (Id. p. 76.)

Company witness Simpson testified that DEC provides service to approximately 2 million customers in North Carolina, where the Company has more than 100,000 miles of lines and over 1600 substations. (Tr. Vol. 16, p. 90-91.) He indicated that in the last four years, the Company has spent $2.6 billion dollars maintaining and upgrading that system: $1.8 billion has gone to investments in distribution, while $770 million has been invested in its transmission system. (Id. at 92.) Distribution investments include connecting new customers, lighting installations, capacity additions, and infrastructure maintenance and upgrades, while the Company's transmission investments include addressing capacity and compliance projects, as well as replacement of wood poles, obsolete substations, and line equipment. (Id. at 93-94.) Witness Simpson also discussed the need for the Company's customary rate of spend in calendar years 2017 through 2021 to invest in maintenance of the grid and to ready it for new customers. (Id. at 106.) In his direct testimony, Mr. Simpson stated that the Company anticipated T&D expenditures over the next five years in the amount of $4.5 billion. (Id.)[4]

Witness Simpson stated that despite these investments, DEC's system has been challenged by more severe weather and equipment failures that have manifested themselves in worsening reliability across DEC's grid. (Tr. Vol. 16, p. 100.) He projected that in the next ten years, the grid will be challenged by more frequent and severe weather events. At the same time, the grid is aging, with approximately 30% of the Company's infrastructure passing the end of its design life in the next ten years. (Id. at 103.) Witness Simpson indicated that this older equipment, despite being well-maintained, is one of the top drivers for the worsening reliability metrics, as it is more likely to fail when stressed by inclement weather and is more time-consuming to repair. (Id. at 89, 124.)

Witness Simpson testified that the Power/Forward initiative will transform the Company's 20th century grid to a state-of-the-art, more reliable and resilient 21st century grid which will benefit customers and the state as a whole. It is a holistic, ten-year program, consisting of targeted undergrounding, hardening and resiliency investments, installation of self-optimizing grid, advanced metering infrastructure, communication network upgrades, and deployment of advanced enterprise systems. (Id. at 108-14.) Witness Simpson noted that Power/Forward spending would be in addition to $3.4 billion in customary spend on its T&D system in calendar years 2017 to 2021. (Id. at 106, 164.) He characterized 90 percent of planned Power/Forward spending as related to grid modernization, while 10 percent is related to "retrofitting transformers to eliminate common outage causes." (Id. at 119.) Witness Simpson testified that the Power/Forward investments are needed because of changing customer needs. (Id. at 123.)

On cross-examination, witness Simpson testified that there is a work plan for the first year of Power/Forward, but it had not been filed with the Commission as of March 19, 2018. (Tr. Vol. 16, p. 169.) Regarding the Company's reliability statistics, he testified that the statistics typically vary from year to year, and conceded that DEC saw an improving trend from 2003 to 2012 without implementing a Power/Forward-type program or a rider. (Id. at 177-83.) As to the distinction between Power/Forward and customary spend, witness Simpson testified on cross-examination that a layperson or even an engineer from an electric cooperative may not be able to distinguish Power/Forward from customary spend construction, but DEC is able to. (Tr. Vol. 16, pp. 194-97.) Witness Simpson further testified that, even where DEC has identified specific amounts of targeted undergrounding, it has not actually decided which locations or how much will be

[4] In his rebuttal testimony, however, Mr. Simpson lowered that projection by $1.1 billion to reflect the removal of certain expenses linked to grid modernization initiatives. (Tr. Vol. 23, p. 179 and Simpson Rebuttal Exhibit 3.)

underground. (Tr. Vol. 18, pp. 231-32). He also testified that DEC would proceed with Power/Forward as planned, within the same time frame, even without the GRR Rider. (Tr. Vol. 17, p. 32.) Witness Simpson testified that the top three causes of outages are "vegetation, equipment failure, and public accidents." (Tr. Vol. 17, p. 111.) On cross-examination, witness Simpson acknowledged that the Company had not done statistical analysis regarding outage causes, trends, and the overall trend in reliability statistics. (Tr. Vol. 24, p. 26.)

In his rebuttal testimony, DEC witness Simpson testified that work plans "are to be finalized the year before to support the GRR Rider." (Tr. Vol. 23, p. 161.) He acknowledged that many of the projects do not seem different from customary T&D expenditures, but argued that the data analytics are now different. (Id. at 164-67.)

Public Staff witness Williamson testified that DEC's description of Power/Forward is too broad, open-ended, and lacks sufficient detail to warrant approval of the GRR Rider, and suggests the Commission should require DEC to submit additional information. (Tr. Vol. 22, pp. 36-38.) He also recommended that, if allowed, the GRR Rider should be limited to "extraordinary, discrete, non-growth related, cost effective projects focused on grid modernization, as opposed to grid maintenance and support." (Id. at 38.) He recommended excluding targeted undergrounding, distribution hardening and resiliency, and AMI deployment from the GRR Rider as indistinguishable from customary spend. (Id. at 40-41.)

Public Staff witness Maness testified that not all Power/Forward components will result in grid modernization, rather than normal system improvements DEC is obligated to make, and that the GRR Rider as proposed should be rejected. (Tr. Vol. 22, pp. 88-89.) He further explained that the proposed rider would upset the balance achieved by considering rates in their totality. (Id. at 90.) Witness Maness noted the Public Staff's concerns that the proposed GRR Rider would cover routine maintenance costs, that the types of projects proposed by DEC are vague and likely to result in disputes in any rider proceeding, and that the rider process would strain Commission, Public Staff, and intervenor resources. (Id. at 90-91.) He further testified that splitting off Power/Forward costs into a rider proceeding would remove incentives to avoid imprudent spending that are inherent in general rate case proceedings, and that a rider would make it more likely that DEC will exceed its allowed rate of return. (Id. at 92-93.) Witness Maness further suggested that DEC be required to obtain pre-approval for any projects for which it will seek to recover costs under the rider. (Id. at 98.)

CUCA witness O'Donnell calculated that DEC's Power/Forward initiative will increase rates significantly, with residential customers seeing as much as a 52.50 percent increase over 10 years. (Tr. Vol. 18, p. 29.) He examined statements by DEC indicating it plans to use grid investments to drive earnings. (Id. at 34-37.) He testified that DEC is seeking to use the GRR Rider to transfer risk of cost recovery onto ratepayers. (Id. at 34, 50-51, 155.) Witness O'Donnell explained that DEC's Power/Forward initiative reflects similar efforts by utilities across the country, but distinguished DEC's plan as much larger, more expensive, and less transparent than other utilities' programs. (Id. at 37, 43-48.) He supported creation of a separate docket to consider grid investments. (Id. at 48.)

EDF Witness Alvarez recommended requiring Commission approval for grid modernization projects, noting that it would be practically more difficult to deny costs after investments are made. (Tr. Vol. 26, pp. 307-08.) He also recommended establishing a separate proceeding to address grid modernization. (Id. at 308-10.)

Kroger witness Higgins criticized the proposed GRR Rider as single-issue ratemaking, and noted that the proposed rider is not supported by circumstances similar to those the Commission has previously found to justify the use of a rider. (Tr. Vol. 4, pp. 509-10.)

CIGFUR III witness Phillips criticized the proposed GRR Rider as single-issue ratemaking for investments that do not justify rider treatment, that inappropriately shifts risk from DEC to ratepayers, and that distorts incentives for prudent investment. (Tr. Vol. 26, pp. 276-79.)

Tech Customers witness Strunk testified that DEC has not distinguished its planned spending under the Power/Forward program from customary T&D spend. (Tr. Vol. 26, 475-79.) Describing the significant overlap in the projects between the two categories of spending, witness Strunk identified the risk that DEC will pursue recovery or ordinary T&D costs through the proposed rider. (Id. at 477-79.) He testified that the proposed rider threatens to unbalance the regulatory process by moving large capital investments outside of the general rate case process. (Id. at 480.) He testified that the rider is unnecessary to reduce regulatory lag, in part because utilities and the Commission have other means of addressing lag. (Id. at 481-82.) Witness Strunk testified that DEC's proposal is distinguishable from capital trackers employed in other jurisdictions by its failure to clearly identify eligible assets, its lack of a limit on investments, and its failure to recognize offsetting cost savings. (Id. at 483.) He criticized the economic study submitted by DEC as flawed because it focused on indirect benefits, excluded analysis of risks, and lacks a clear showing of a deteriorating trend in reliability. (Id. at 486-95.)

In response to Tech Customers witness Strunk, witness Simpson testified that the distinction between T&D projects that would be undertaken under the GRR Rider and customary T&D projects is "about the pace of the expenditures, not the classification of the investment." (Tr. Vol. 23, p. 169.) He disputed that the GRR Rider would incentivize pursuing recovery of customary T&D spend via the rider, arguing that Power/Forward "is comprised of a specific set of projects." (Id. at 170.) Regarding potential risks of the initiative, witness Simpson asserted that Power/Forward is flexible enough to address and mitigate risks as they arise. (Id.

at 173-74.) With regard to vegetation, he testified that vegetation management alone could not address all investments covered under Power/Forward. (Id. at 178-79.) In response to witness Golin, witness Simpson conceded that some of the projects described under Power/Forward "do indeed have similar descriptions as customary [T&D] spending." (Id. at 180.)

Discussion

The Commission concludes that DEC has not shown the proposed Power/Forward investments are reasonable or prudent, that the GRR Rider is necessary to make such investments, or that the proposed rider would be in the public interest.

As DEC's President, Mr. Fountain, and DEC witness Simpson conceded, DEC does not claim it will not make the proposed T&D investments without the GRR Rider. (Tr. Vol. 6, p. 431-32; Tr. Vol. 17, p. 32.) DEC argues the rider "is necessary to accelerate the T&D investments being made," Application at 5-6, implying that it may not invest as rapidly without approval of the rider. But DEC does not contend that there is an immediate or pressing need for any particular investment that it will not make without the rider. Rather, as DEC witness McManeus explained, "the reason that the Company requests a rider is to address the issue of regulatory lag that exists in any general rate case proceeding . . . that would have the adverse effect of reducing cash flows and earnings." (Tr. Vol. 6, pp. 440-41.) Put another way, DEC's proposal is driven by convenience to it, not by special circumstances or an inability to recovery its investment through normal channels.

On cross-examination, Mr. Fountain conceded that it is DEC's parent's corporate policy to drive earnings growth by pursuing grid modernization investments, including the Power/Forward initiative. (Tr. Vol. 6, p. 434-35; Tr. Vol. 6, pp. 440-41.)

It is clear from the testimony of the parties that the GRR Rider would have a number of beneficial effects on DEC's earnings, including that it would (1) increase rate base at a faster rate than DEC would otherwise achieve by accelerating DEC's investment in T&D infrastructure beyond customary spend levels; (2) ensure more rapid recovery of earnings from those T&D investments; (3) allow DEC to avoid the costs of periodic general rate cases; (4) allow DEC to keep savings resulting from operating expense reductions resulting from T&D infrastructure improvements; and potentially (5) allow DEC to earn a return on equity that does not reflect its decreased risk from reduced regulatory lag.

These are reasons why the GRR Rider would be beneficial to DEC, but benefits to DEC are not this Commission's only consideration; as it has recently acknowledged, "the Commission's task is to set rates as low as possible consistent with the dictates of the United States and North Carolina Constitutions." Order

Granting Partial Rate Increase, Docket No. E-2, Sub 1142, at p. 59 (Feb. 23, 2018) (citing State ex rel. Utils. Comm'n v. Pub. Staff-N. Carolina Utils. Comm'n, 323 N.C. 481, 490, 374 S.E.2d 361, 370 (1988)). In this case, this goal collides with DEC's admitted goal of using investment to drive earnings growth. (Tr. Vol. 6, pp. 434-35.) And the evidence strongly suggests that DEC's proposed T&D investments are driven more by top-down corporate concerns about the need to "drive earnings" rather than the bottom-up need to modernize DEC's grid. Notably, the intervening parties are remarkably aligned in their concerns with the various deficiencies of DEC's proposed Power/Forward program and GRR Rider. See, e.g., Tr. Vol. 4, pp. 491-95 (Kroger witness Higgins); Tr. Vol. 14, pp. 18-65 (NCSEA witness Golin); Tr. Vol. 26, pp. 276-79 (CIGFUR III witness Phillips); Tr. Vol. 26, pp. 465-95 (Tech Customers witness Strunk).

DEC has failed to support its request with specific plans to justify the proposed spending and has failed to adequately distinguish the Power/Forward initiative projects from customary T&D spending.

Based on DEC's presentation of its proposal in its Application and testimony, the attribution of costs into the grid modernization category is seemingly arbitrary. Indeed, DEC has failed to specify any particular investment it plans to make if the GRR Rider is implemented. DEC's Application and testimony are devoid of any description of specific planned expenditures. Instead, DEC resorts to broad, amorphous descriptions of categories of potential expenditures such as "targeted undergrounding, distribution hardening & resiliency, and the self-optimizing grid." (Tr. Vol. 16, pp. 108-17.) In a late-filed exhibit submitted after the close of the hearing, DEC purports to provide clarity as to its immediate investment plans, see DEC's Power/Forward Carolinas Late-Filed Exhibit, Docket No. E-7, Sub 1146, at p. 1 (Apr. 2, 2018), but that filing also fails to identify specific projects to be funded. Attachment A to the filing—DEC's purported 2018 work plans—explicitly disclaims that any identified project will actually be undertaken, noting that the "projects and work streams outlined for 2018 are a snapshot" and that "[p]roject scopes and budgets will be modified." And Attachment B—DEC's purported 2019 work plans—provides no budget or other cost information for any listed project. With regard to transmission projects, Attachment B states that it describes "Power Forward and Transmission base spending for Power Forward like projects," Attachment B at 245, and does not actually specify what is included within the scope of Power/Forward. None of the attachments provide justification for any particular project.

In a response to the Commission's April 19, 2018 Order Requiring Filing of Law-Filed Exhibit, DEC made a supplemental filing explaining that its witness's exhibits showing 15 projects totaling $75 million in areas deemed "Areas of Vulnerability" was merely based on an a project budget of $75 million, and the "Company . . . cannot now file a list of what these 15 projects are or why they meet Area of Vulnerability criteria because the 15 project units . . . are not actual projects." The filing represents a microcosm of the GRR Rider proposal as a whole: DEC has a definite desire to spend large sums of money, but little in the way of specifics to justify that spending.

As demonstrated by the table set forth in the testimony of Tech Customers witness Strunk, DEC has not been able to articulate any substantial difference between the kind of projects funded by customary T&D spending and those proposed to be funded by the GRR Rider and that DEC's descriptions of its proposed rider investments are indistinguishable from conventional T&D investments. (Tr. Vol. 26, pp. 475-79.) DEC effectively concedes this point; as stated by DEC witness Simpson in his rebuttal testimony, the distinction between T&D projects that would be undertaken under the GRR Rider and customary T&D projects is "about the pace of the expenditures, not the classification of the investment." (Tr. Vol. 23, p. 169.)

The lack of distinction between the proposed Power/Forward program and customary T&D investment creates the risk that DEC will seek to recover, outside of the general rate case process, the costs of and a return on what are really customary T&D investments. (Tr. Vol. 26, p. 479.) Moreover, this lack of distinction—noted by many of the parties—would make the annual review proceedings envisioned by DEC confusing and difficult for the parties and the Commission, as there will undoubtedly be insoluble disagreements on whether particular spending should qualify for recovery under the rider. This definitional ambiguity further demonstrates the unsuitability of the mechanism proposed by DEC to further its plans for earnings growth.

As noted by the Commission in the 2018 DEP Order, "the burden of proof is on the Company to support the prudence of investments in grid modernization if and when it seeks cost recovery of such investment." Order Accepting Stipulation, Decided Contested Issues and Granting Partial Rate Increase, Docket No. E-2, Sub 1142 (Feb. 23, 2018), at 99. While that burden of proof was not required in the DEP proceeding because DEP did not seek approval of a cost recovery rider, the Commission nonetheless concluded, "Based on the full record in this docket, the Commission concludes, however, that the Company has not yet provided compelling evidence that the proposed grid investment plan will result in meaningful benefits to ratepayers despite its cost." Id., at 99-100. DEC's burden of proof is fully applicable here in light of DEC's request for approval of the GRR Rider; however, the evidence provided by DEC in support of the GRR Rider is not materially different from the evidence presented by DEP in the prior proceeding. Given this, the Commission is compelled, once again, to conclude that the Company has not yet provided compelling evidence that the proposed grid investment plan will result in meaningful benefits to ratepayers that justify its considerable cost.

In short, DEC has not shown that the proposed investments are necessary, reasonable, and prudent, which is the linchpin of this State's ratemaking processes. For these same reasons, the Commission concludes that it should deny the Company's request for establishment of a regulatory asset to recovery Power/Forward costs in a future rate case. While in some circumstances, establishment of a regulatory account has been found to be reasonable and appropriate, the Commission concludes that insufficient justification has been presented to warrant this extraordinary mechanism here.

In further support of these conclusions, the Commission notes that evidence of a deterioration in network reliability is even less compelling here than in the DEP proceeding, where the Commission concluded that DEP had not demonstrated that the plan would result in meaningful benefits to ratepayers. In the DEP proceeding, DEP presented evidence on reliability metrics showing that the frequency of outages had increased from 1.2 average interruptions in 2014 to approximately 1.3 in 2016, and that the average duration of interruptions had increased approximately 45% since 2013; and that the number of events "has gone up 25% in the past four years." (2018 DEP Order at 96.) In this proceeding, Witness Simpson presented a graph depicting SAIFI and SAIDI trends, but he did not offer a specific analysis of those trends, rather he simply characterized them as worsening. Based on review of the underlying data supporting Witness Simpson's graph, however, the Commission finds that DEC's data show that the frequency of outages has increased from 0.93 average interruptions in 2014 to approximately 1.07 in 2016 (an increase of 0.14 outages per customer), and the average duration of interruptions has increased approximately 28% since 2013. (Simpson Tech Customers Cross-Examination Exhibit 1.) DEC did not offer testimony on the number of events over the past four years. DEC presented no objective standards with which to measure these data, and its own witness conceded that SAIFI and SAIDI data would be expected to fluctuate from year-to-year based on, e.g., weather cycles. (Id. at 177-83.) Moreover, examination of trend data from DEC's previous rate case shows that DEC was able to significantly reduce SAIFI and SAIDI metrics—from levels significantly higher than existing levels—through normal course spending. In addition, DEC's own testimony shows that a primary cause of outage events are vegetation issues, yet DEC's proposal does little to focus on this primary cause; indeed, the evidence indicates that DEC's existing vegetation management program is experiencing a significant backlog.

Moreover, the data cited by witness Simpson in his direct testimony is "DEC System Total (NC and SC)," see DEC's Power/Forward Carolinas Late-Filed Exhibit, Docket No. E-7, Sub 1146, at p. 2 (Apr. 2, 2018), and therefore the statistical analysis does not provide evidence of increased SAIFI and SAIDI metrics within DEC's North Carolina service territory, which is all that is relevant to this case.

The Commission acknowledges the potential rate impacts of implementing Power/Forward. CUCA witness O'Donnell testified that he calculated the impact on rates to range from a 12.45% increase for the Company's commercial customers to a 52.50% increase for the Company's residential customers. (Tr. Vol. 18, p. 29.) Existing dockets (such as Integrated Resource Planning and Smart Grid

Technology Plans) as well as future general rate case proceedings provide opportunities for the Commission to consider evidence evaluating the prudency and reasonableness of Power/Forward costs.

Finally, the Commission notes DEC's submission of an economic report by Ernst & Young showing the economic benefits of its planned Power/Forward investment. Simpson Rebuttal Exhibit 1. Whether the study's methodology was appropriate, and whether it accurately accounts for costs and benefits of the program, have been the subject of considerable controversy among the parties. Those competing contentions need not be addressed. It is clear to the Commission that practically any sizeable investment—and particularly a $13 billion infrastructure investment—will have positive indirect economic effects. Whether there in fact will be overall benefits from Power/Forward initiative after rate increases are accounted for is not relevant to our decision. The Commission's duty is not to promote general economic activity, but rather to ensure that ratepayers pay the lowest possible amount for reliable utility service. Accordingly, the Ernst & Young study does not support the proposed GRR Rider.

Because DEC has failed to support its request for the GRR Rider with a compelling showing that the rider is necessary, the Commission denies DEC's request.

The foregoing explains the Commission's conclusion that the proposed rider is rejected as unsupported by the facts presented here. But on these facts, the GRR Rider is also rejected because it is beyond the Commission's authority to grant.

Through the GRR Rider, DEC effectively seeks to have annual rate increases (effected through rolling increases to a separately determined "rate base") approved through a rider mechanism rather than in general rate cases. The GRR Rider would be used to adjust DEC's rates outside of the Commission's general rate case authority. In fact, the desire to avoid general rate case review of its recovery of T&D investment costs is one of DEC's explicit motivations for requesting the GRR Rider. (E.g., Tr. Vol. 6, p. 270.)

As a starting point, the Commission has recognized that

> North Carolina statutes and case law contain explicit limits as to the procedures through which the Commission may revise the rates of a public utility. They are as follows: (1) a general rate case pursuant to G.S. 62-133; (2) a proceeding pursuant to a specific, limited statute, such as G.S. 62-133.2; (3) a complaint proceeding pursuant to G.S. 62-136(a) and G.S. 62-137; or (4) a rulemaking proceeding.

In re 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, Docket No. E-7, Sub 849, at 18 n.2 (June 2, 2008) ("In re DEC Drought Rider"); *accord* State ex. rel. Utilities Commission v. Nantahala Power and Light Company*,* 326 N.C. 190, 195, 388 S.E.2d 118, 121 (1990). DEC's proposed rider in this proceeding comports with none of these procedures. DEC has not sought to initiate a rulemaking proceeding; DEC has not shown (or even suggested) that it is or will be experiencing an overall operating income deficiency so as to raise the issue of the sufficiency of its base rates through a complaint proceeding under G.S. § 62-136(a); and no statute specifically authorizes a rider to recover "grid modernization" costs. The only remaining procedure under which rates may be increased is a general rate case pursuant to G.S. 62-133.

As set forth in G.S. 62-133, rates are based on (1) expenses and (2) a reasonable return on property that is "used and useful, or to be used and useful within a reasonable time after the test period, in providing" electric service, including allowances for CWIP (the rate base). In contrast, the GRR Rider seeks to treat infrastructure spending as used and useful property for which the utility can earn a return as soon as the investment is made without the need to file a general rate case, without review of whether other costs have decreased, and without review of whether the overall return to the utility is just and reasonable. Nothing in G.S. 62-133 suggests that such an end run should be allowed, and no cases authorize a mechanism for future rate adjustments based on planned infrastructure spending similar to what DEC has requested. To the contrary, it is well-established under North Carolina law that setting rates based on consideration of a single cost factor isolated from other cost considerations (i.e., "single-issue" ratemaking) is prohibited. See, e.g., In re DEC Drought Rider, at 18 & n.2.

Instead, the costs of "used and useful" utility property (such as T&D infrastructure) are included as part of the rate base in a general rate case, G.S. 62-133(b)(1), and the return on such infrastructure is just one component of the rates approved by the Commission as just and reasonable in their totality. Indeed, G.S. 62-133(c) forecloses the setting of rates based on property that is neither "used and useful" nor under construction at the time of the hearing. The North Carolina Supreme Court has held that, under G.S. 62-133(c) as it was then in effect, it was error to include the costs of construction work in progress in rate base because those costs were not specifically allowed by statute. State ex rel. Utilities Commission v. Morgan, 277 N.C. 255, 273, 177 S.E.2d 405, 417 (1970), aff'd on reh'g, 278 N.C. 235, 179 S.E.2d 419 (1971). While G.S. § 62-133(c) was subsequently modified to allow inclusion of CWIP in rate base in limited circumstances not relevant to the GRR Rider, it has never been amended to allow a return on property not yet constructed.

In any event, there is no mechanism allowable within a rate case proceeding to authorize the future recovery of costs and a return on unspecified property that is not yet under construction, much less been placed into service, for which the costs and timing are completely within the control of the utility. In this regard, and in sheer size and scope of the spending to be made, the GRR Rider is unlike any rider this Commission has approved in the past.

DEC suggests that the Commission can approve its GRR Rider request because it has been made in conjunction with a general rate case. Application at 6 n.2. DEC primarily relies on the North Carolina Supreme Court's decision in State ex rel. Utilities Commission v. Edmisten, 291 N.C. 327 (1976) ("Edmisten I") in which the Court affirmed the Commission's approval of a fuel adjustment rider in connection with a rate case. DEC also cites the Commission's approval of coal inventory riders in connection with DEC's 2009 and 2013 rate cases. *See* Docket No. E-7, Sub 909 (2009) and Docket No. E-7, Sub 1026 (2013). Finally, DEC states that the GRR Rider would operate similarly to "analogous riders" approved by the Commission, including the joint agency asset rider (JAAR) (Docket No. E-2, Sub 1088 (2016), and the Bulk Power Marketing (BPM) true-up rider (Docket No. E-7, Sub 1026 (2017). Each of the cases cited by DEC is readily distinguishable from DEC's request here.

Edmisten I approved use of a fuel adjustment rider in connection with a general rate proceeding. There the Court noted that the rider in issue "does indeed isolate for special treatment only one element of the utility's cost" but nonetheless approved the additive since it was adopted in connection with a general rate case and was of a nature that merely involved the application of a mathematical formula to the established rates going forward. See 291 N.C. at 339. Notably, however, (a) the rider was adopted in the context of exigent circumstances related to the national fuel crisis in the 1970s following the utility's demonstration of a clear connection between the fuel charges and its financial viability; (b) the rider permitted the recovery of core operating expenses that are now recoverable under express statutory mechanisms; and (c) the additive approved was one, unlike the GRR Rider, that did not involve going forward cost assessments or evaluations (essentially a miniature rate case) but rather permitted rate adjustments by application of a mathematical formula. In other words, the Commission established just and reasonable rates and then adopted a going-forward adjustment mechanism that it found necessary to achieve those rates based on the exigencies of the energy crisis impacting the utility's costs. Crucially, the Supreme Court recognized in upholding the rider that the "Commission, cognizant of its primary duty to fix just and reasonable rates, found upon uncontradicted evidence that the only way it could perform this duty under the facts was to permit use of the fuel clause." See id., at 346 (emphasis added).

None of the factors supporting adoption of the fuel adjustment rider in Edmisten I are present here and DEC has come nowhere close to showing that just and reasonable rates can be fixed only by use of the proposed rider. Where Edmisten I addressed fuel costs to be incurred by the utility as an essential component of its utility operations, while DEC proposes recovery of future T&D expenditures for projects not yet identified, which are discretionary on its part, and which, by their nature, will have potential spill-over impacts on other aspects of DEC's cost structure. Where Edmisten I was decided in the context of wildly fluctuating fuel costs that threatened the utility's financial viability, here, DEC has complete control over the proposed spending. And where Edmisten I approved what was essentially a mathematical formula, here DEC seeks to create a "mini rate case" operating in parallel to its general rate case proceedings. Contrary to DEC's suggestion, Edmisten I cannot be read to endorse an end-run around the statutory rate-setting mechanisms; to the contrary; central to the Court's holding in that case was the Commission's conclusion that the rider was critical to the achievement of the statutorily prescribed rates.

The coal inventory riders approved in connection with DEC's 2009 and 2013 rate cases,[5] provide no support for the adoption of the GRR Rider here. In the 2009 and 2013 proceedings, the Commission adopted an increment rider to permit DEC to recover the additional costs of carrying coal inventory in excess of the target inventory level. In both proceedings, the Commission found that DEC's fuel procurement practices were reasonable and appropriate, that they had been reviewed in the annual fuel cost adjustment proceedings, that the excess coal inventory was caused by circumstances beyond DEC's control (economic downturn and milder than normal seasonal weather conditions), and that the carrying costs associated with the excess coal inventory was appropriately recoverable from ratepayers. In contrast, here DEC seeks approval of a mechanism to recover yet-to-be-incurred T&D expenses that have not been approved or endorsed by the Commission as reasonable or prudent. (Indeed, they have not even been identified by DEC.)

Finally, DEC's reference to the Commission's approval of the Joint Agency Asset rider ("JAAR") and Bulk Power Marketing (BPM) true-up rider do not support the GRR Rider request; to the contrary, they confirm the point that the Commission lacks authority to adopt the GRR Rider. The JAAR establishes a mechanism by which Duke Energy Progress, LLC, is permitted to recover costs associated with its purchase of the North Carolina Eastern Municipal Power Agency (NEMPA) ownership interests in certain generating facilities—an extraordinary mechanism was created pursuant to specific authority: G.S. § 62-133.14. See In re Application by Duke Energy Progress, LLC for Approval of Joint Agency Asset Rider for Recovery of Costs Related to Facilities Purchased from Joint Power Agency Pursuant to G.S. 62-133.14 and Rule R8-70, Docket No. E-2, Sub 1110, 2016 N.C. PUC LEXIS 1052, *1 (Nov. 7, 2016). Similarly, the BPM rider is a decrement rider that was adopted as a mechanism for sharing DEC's profits from bulk wholesale sales. *See, e.g.,* Docket No. E-7, Sub 751; Docket No. E-7, Sub 1026, at 13 (2017). The BPM rider was adopted pursuant to express statutory authority set forth in G.S. 62-133.6(e)(2) (permitting the Commission to approve a reduction in

[5] *See* Order Granting General Rate Increase, Docket No. E-7, Sub 909, at 43-45 (2009), and Order Granting General Rate Increase, Docket No. E-7, Sub 1026, at 113-115 (Sept. 24, 2013).

rates during the Clean Smokestack Act freeze period), and it has no applicability to DEC's proposal here to *increase* rates based on unspecified future infrastructure expenditures.

Most similar to DEC's proposal infrastructure improvement and replacement recovery riders for natural gas utilities and water and sewer utilities approved by the Commission pursuant to G.S. 62-133.7A and 62-133.12. The General Assembly's creation of statutory authority for rate adjustment mechanisms for these and other purposes—none of which apply to the GRR Rider, *see* G.S. 62-133.1-.15—makes clear that the Commission lacks authority to create a rate adjustment mechanism for an electric public utility's T&D investments.

The line of Commission decisions rejecting proposed riders further supports rejection of the proposed GRR Rider.

For example, in rejecting DEC's request for implementation of a rider to recover costs associated with a prolonged drought in the In re DEC Drought Rider proceeding, the Commission reaffirmed that its ability to revise public utility rates was constrained by statute to the four statutory mechanisms noted above. See In re DEC Drought Rider, at 18 n.2. Because DEC's request for a drought rider did not involve any of these mechanisms, the Commission concluded that DEC's request was an impermissible "piecemeal approach to ratemaking" that would be legally inconsistent with "the manner in which the Commission may lawfully revise the rates of public utilities in this State." Id. at 18.

In a case closely analogous to this one, the Commission addressed whether the utility could recover the costs of replacing bare steel and cast-iron mains and services through a rider, when the collected funds would be used to pay for expansion facilities. In re Pub. Serv. Co. of N.C., Docket No. G-5, Sub 356, at 10-13 (Sept. 25, 1996) ("PSNC"). The Commission explained that its legal authority to authorize riders that have the effect of adjusting rates outside of general rate cases applies only "in very limited circumstances involving highly variable and unpredictable expense or volume levels beyond the control of the utility." Id. The Commission rejected this rider as unlawful for a number of reasons. First, the Commission found that "the cost had not been shown to constitute an unpredictable portion of . . . annual construction expenditures" and the utility "has had control as to how much, how often and when the replacement takes place," meaning the "expenditures are not highly variable or unpredictable, and they are generally controllable" by the utility; accordingly, the rider did not fall within the Commission's limited rider authority. Id. at 11. Second, the proposed rider "violate[d] traditional ratemaking principles" with "insufficient justification to treat the[] expenditures differently from other similar expenditures." Id. Noting that PSNC had been replacing bare steel and cast-iron mains and services for decades, the Commission concluded the rider would be inappropriate because "[t]his long history indicates that PSNC is fully capable of maintaining a strong, viable company without the need for a special surcharge of this nature." Id. The

Commission noted a number of other concerns, including the possibility that rates would become unreasonable because the rider "would permit PSNC to recover the cost of the replacement mains without recognition of associated decreases in expenses or increases in revenues," a concern that was magnified "by the sheer magnitude and pace of PSNC's replacement program." Id. at 12. The Commission further noted that the rider "would require present ratepayers to pay for certain capital improvements as the funds are expended, rather than as the service is provided," which would "cause current ratepayers to subsidize the cost of serving future generations of ratepayers." Id.

Similarly, the Commission rejected the request of Virginia Electric and Power Company, d/b/a North Carolina Power ("NC Power"), for an annually adjustable nonutility generation ("NUG") rider, even though this request was made in the context of a general rate case. In the Matter of Request of North Carolina Power for Authority to Adjust Its Electric Rates and Charges, Order Approving Partial Rate Increase, Docket No. E-22, Sub 314 (Feb. 14, 1991) ("In re VEPCO"). There, NC Power sought approval to recover future non-utility generation expenses that it was contracted to incur over the next seven years through an NUG rider, with both deferred accounting and true-ups. *See* Finding of Fact No. 8, p. 7. In rejecting this request, the Commission found that an annual adjustment for purchases of this type outside a general rate case was not authorized by statute, that there was insufficient justification for treating purchased power expenses any differently from other expense items in the ratemaking process, and that the "rider mechanism would preclude appropriate regulatory oversight of the Company's overall expenses. . . . because increases in payments to NUGs for additional capacity and energy could be offset by decreases in other cost of service items" that would not be accounted for without a general rate case. Id., at p. 19-20. Based on these "policy and legal concerns," the Commission denied NC Power's request.[6]

The GRR Rider is analogous to the riders addressed in PSNC and In re VEPCO, and is rejected for the same reasons. DEC has control over the amount it invests in T&D and, therefore, these expenditures are entirely predictable (indeed, determinable) by DEC; the proposed Power/Forward program seeks to address costs of the kind DEC has addressed historically without use of a rider; there has been no showing that DEC will not remain a strong, viable company without the rider; DEC explicitly seeks to keep any savings it realizes as a result of

[6] The Commission also noted that the fuel charge adjustment statute had been narrowly construed by the appellate courts, citing State ex rel. Utils. Comm'n v. Thornburg, 84 N.C. App. 482, 353 S.E.2d 413 (1987). There the Court overturned the Commission's use of an "experience modification factor" to allow CP&L to recover a past under-recovery of fuel costs. 84 N.C. App. at 490, 353 S.E.2d at 418. In light of the holding of the Court of Appeals, the Commission concluded "that an adjustment to base rates outside a general rate case, for which there is no specific statutory authority, to reflect a true-up of NUG expenses would be found unauthorized." In re VEPCO at 19.

its proposed $13 billion program; and the rider allows recovery of costs as they are expended, rather than as service is provided. Given the reasoning of PSNC and In re VEPCO and the facts presented in this case, approval of the GRR Rider is clearly outside the scope of the Commission's authority. Accordingly, DEC's request is denied.

Finally, the Commission will not open a separate docket for grid modernization planning and/or revisions to existing Commission rules at this time. DEP has scheduled in May 2018 a technical workshop to involve stakeholders in its plans for grid modernization, and the Commission believes the stakeholder process should be allowed to play out before additional resources are spent on this issue. The Commission will reconsider proposals for a formal grid modernization proceeding pending the effectiveness of the technical workshop in the DEP case, Integrated Resource Planning, and Smart Grid Technology Plans to evaluate grid investment plans.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 9-11 [TAX REFORM]

The evidence supporting these findings and conclusions is contained in the verified Application and Form E-1 of the Company, the testimony and exhibits of the expert witnesses, and the entire record in this proceeding.

On December 22, 2017, the Federal Tax Cuts and Jobs Act of 2017 (FTCJA) was signed into law, lowering the federal corporate income tax rate from 35% to 21%. On January 3, 2018, the Commission issued an Order in Docket No. M-100, Sub 148 initiating an inquiry into the effects of the FTCJA. The Commission's Order included notice to affected utilities that effective January 1, 2018, the federal corporate income tax expense component of all existing rates and charges will be billed and collected on a provisional rate basis.

The Company initiated this general rate case on August 25, 2017, by filing its application and supporting testimony. As the adoption of the FTCJA postdated the initiation of this proceeding, DEC's initial proposed revenue requirement was submitted based upon the federal corporate income tax rate in effect at that time. At the hearing in this matter, however, DEC notified the Commission of its intention to implement the reforms prescribed in the FTCJA as part of its general rate case, rather than in the generic tax proceeding. (Tr. Vol. 5, p. 14.) Subsequently, DEC introduced testimony and revised exhibits and supporting workpapers describing its position regarding the implementation of federal tax reform.

Given that the issue relating to the implementation of federal tax reform was introduced into this proceeding after the filing of testimony by the parties, the parties have addressed this issue through supplemental testimony, examination at hearing, and in briefing—all of which is relied upon in the Commission's conclusions below.

In its redirect of its witness De May at the hearing, the Company presented its proposal to flow-through the benefits of federal tax reform. The Company proposes to incorporate a $216 million reduction in revenue requirements to reflect federal corporate income taxes at a 21% rate rather than a 35% rate. (Tr. Vol. 5, p. 67; Rebuttal Ex. 5 (De May), Supplemental Comments of DEC and DEP, Docket No. M-100, Sub 148, at 3 (March 1, 2018).)[7] With regards to the return of EDIT, the Company differentiates between "protected" EDIT, which is subject to IRS normalization rules, and "unprotected" EDIT, which is not. DEC proposes to return protected EDIT to ratepayers in accordance with IRS normalization rules, which generally require protected EDIT to be returned over the remaining useful life of the asset from which it derives. (Tr. Vol. 5, p. 67; Rebuttal Ex. 5 (De May), Supp. Comments of DEC and DEP, Docket No. M-100, Sub 148, at 2-6 (March 1, 2018).) DEC further proposes to return "unprotected" EDIT to ratepayers differently, depending on whether it is "unprotected PP&E"—to be returned to ratepayers over 20 years—or "unprotected other"—to be returned to ratepayers over five years. (Id.; Tr. Vol. 5, pp. 77-79.) Finally, DEC proposes that the Commission approve $200 million in additional accelerated depreciation to collect certain expenses, such as AMR meter or coal-fired plant depreciation and coal ash basin closure compliance costs, on an accelerated basis. (Id.; Tr. Vol. 5, pp. 81-83.) DEC asserts that this accelerated recovery is necessary to smooth out rate volatility by adjusting the timing of payment of costs that otherwise would be paid by ratepayers at a later date, resulting in an approach that balances the importance of delivering savings to customers with upholding the Company's financial strength. (Id.)

The Public Staff proposes returning protected EDIT as prescribed by the IRS, returning all unprotected EDIT to ratepayers via a five-year levelized rider, and otherwise immediately flowing through all benefits of the FTCJA to ratepayers without any revenue requirement increase to offset the resulting lower rates. (Tr. Vol. 26, pp. 635-39.) Public Staff witness Boswell explained that use of a five-year period would increase rate stability for ratepayers during the flowback period, resulting in a significantly smaller increase after the rider expires. (Id., at 638.) Witness Bowell also casts doubt on the Company's concern about potential adverse impact on its credit metrics, stating that the Public Staff does not agree that the Commission should allow such concerns to determine its actions and observing that the Company has failed to present evidence of harm. (Id.) As to the Company's proposed $200 million annual revenue increase, witness Boswell notes the Public Staff's "adamant" opposition, stating that the proposal would eliminate virtually the entire benefit of the tax rate reduction for current ratepayers. (Id., at 639-640.) Boswell further criticizes DEC's proposal for failing to provide

[7] In its most recent filings, DEC has recalculated the reduction to its revenue requirement as $211 million. See Revised Exhibits and Workpapers of Witness McManeus, filed April 19, 2018. The Public Staff appears to be in agreement with this recalculation. See Boswell Third Supplemental and Stipulation Ex. 1, at Schedule 1, p. 2, filed April 10, 2018.

details or supporting information regarding the future expenses the Company would offset nor any support for changing the depreciation rates for any particular assets. (Id.) Boswell further stated the Public Staff's position that it is neither fair nor reasonable, and would constitute inappropriate ratemaking, to depart from the transparent process of setting depreciation rates in the course of a general rate case simply to delay flowing through the benefit of reductions in an entirely separate category of costs (income taxes). (Id.)

In Supplemental Testimony, Public Staff witness Hinton responded to information presented by Company witness De May in regard to credit metrics and the risk of a downgrade of the Company's debt rating as a result of the Public Staff's proposals to adjust the Company's revenue requirement as a result of the FTCJA. Mr. Hinton presented an analysis of projected FFO/Debt ratios under the Public Staff's recommended approach as to the return of unprotected EDIT showing that the ratio would remain near or at the Company's target level over the forecast period. (Tr. Vol. 22, pp. 265-269; Confidential Ex. JRH-2.) Witness Hinton further explained that a temporary decrease in the FFO/Debt ratio would be unlikely to lead to the Company's credit rating, especially given that the ratings companies look at financial metrics over a course of several years rather than focus on temporary aberrations and, in any event, credit metrics was only a portion of the overall credit analysis. (Tr. Vol. 22, pp. 267-269). Witness Hinton also testified that DEC's credit rating was the highest among the Duke Energy subsidiaries and that DEC had other sources of funds available other than indicated by the projected FFO/Debt metrics. (Id.)

The Tech Customers offered Supplemental Testimony of witnesses Strunk and Brown-Hruska. These witnesses evaluated the reasonableness of DEC's contention that a $200 million annual increase in spending was necessary to support its credit metrics. Based on the projected FFO/Debt ratios offered by DEC's witness De May and a review of the most recent credit assessment of Standard and Poor's, witnesses Strunk and Brown-Hruska found that DEC's projected FFO/Debt ratios, adjusted to eliminate the request for an additional $200 million in cash flow, do not jeopardize the Company's credit metrics. (Tr. Vol. 26, p. 514.) Instead, their analysis study shows that DEC is on track to maintain, or even exceed, its stated FFO/Debt ratio goal after implementation of federal tax reform. (Id.) Witnesses Strunk and Brown-Hruska also compared DEC's FFO/Debt ratio to those of comparable companies, including those in Mr. Hevert's proxy group, and found that DEC's ratios are in line with, or above, those of the comparable companies and that its FFO/Debt ratios are amount the healthiest amount the proxy group companies both on a current and projected basis. (Id., at 516-517.) Based on this analysis, the Tech Customers witnesses concluded that DEC's rationale for its proposal was inconsistent with the financial forecasts it has provided in its own exhibits and not necessary to protect its current credit standing. (Id., at 519.)

After careful consideration of all the evidence in this proceeding, the Commission finds and concludes that the effects of the FTCJA as to the rates charged by the Company should be addressed in this general rate case rather than the separate, generic proceeding initiated by the Commission in Docket No. M-100, Sub 148. All parties appear to be in agreement that the effects of federal tax reform for DEC should be addressed in this proceeding. Further, the Commission notes that it is required in this general rate case to, among other things, account for the Company's operating expenses for the test year, " taking into account "evidence . . . tending to show actual changes in costs." See, e.g., G.S. 62-133(b)(3) and (c). This statute suggests, if not mandates, that the Commission implement tax reform in this proceeding.

No party has taken the position that, for purposes of the rates set in this proceeding, the amounts collected from ratepayers to defray the Company's federal corporate income tax obligations should not be calculated based on the federal income tax rate established by the FTCJA. The Commission accepts the position of DEC and the Public Staff and concludes that DEC's going forward rates should be calculated to take into account the tax rate established by the FTCJA.

The manner in which Excess Deferred Income Taxes (EDIT) should be returned to ratepayers is more complicated, and there are variety of approaches which could be utilized to return EDIT to ratepayers. EDIT represents amounts collected from ratepayers and held by DEC in excess of future tax liabilities, and the Commission acknowledges that EDIT should returned to ratepayers as expeditiously as possible, taking into consideration the need to avoid undue rate shocks resulting from the elimination of the EDIT deduction from rate base as well as any material degradation of the Company's credit metrics.

DEC contends that protected EDIT should be returned to ratepayers in accordance with IRS rules and that unprotected EDIT should be returned to ratepayers over 20 years, in the case of "unprotected PP&E," and over 5 years, in the case of "unprotected other". The Public Staff agrees that protected EDIT should be returned in accordance with IRS rules but advocates that unprotected EDIT should be returned to ratepayers over five years, via a levelized rider. The Tech Customers agree with the Public Staff's recommendation.

The parties agree that the Commission has discretion over the manner in which unprotected EDIT is returned. (Tr. Vol. 8, p. 224). Based on consideration of all the evidence, the Commission concludes that EDIT associated with DEC's federal corporate income tax obligations should be returned to ratepayers in accordance with the normalization rules of the IRS or, as proposed by the Public Staff, over five years through a levelized rider. The Commission finds that the Public Staff's proposal for return of EDIT best balances the need to return tax overcollections to ratepayers as promptly as possible with the appropriate regulatory goals of avoiding adverse rate impacts for ratepayers and allowing sufficient time for DEC to manage its cash flow so as to avoid negative impacts to its credit metrics.

The Commission does not find support in accounting or ratemaking principles for the distinction in unprotected EDIT advocated by DEC. The PP&E assets for which DEC seeks a 20-year amortization period—like other unprotected EDIT—are not subject to IRS normalization rules. Congress intentionally excluded EDIT from unprotected assets from the treatment given to protected EDIT because the excluded assets do not have normal useful lives. DEC asserts that unprotected PP&E EDIT is similar in nature to protected EDIT (which is also related to PP&E) and therefore it is reasonable to flow it back over a similar period. (Tr. Vol. 5, p. 78.) However, the Commission can discern no principled basis for distinguishing between the assets in the manner proposed by the Company and an examination of the specific assets in this category suggests that they include assets (e.g., casualty loss, depreciation lag, AFUDC debt, pension cost) with highly uncertain accounting lives. (See DEC Response to Public Staff Data Request No. 155-3, filed March 22, 2018.)

Moreover, the Commission believes that twenty years is simply too long a period over which to return over-collected ratepayers' money, and DEC has offered no evidence suggesting otherwise. In this regard, the Commission is sympathetic to the need to return tax over-collections as expeditiously as possible. See, e.g. Buckeye Pipe Line Co., 13 FERC ¶ 61267, 61594 (1980) ("Millions of the Americans who use [electricity] live in poverty or on very tight budgets. Those people are in no position to lend money to anybody. A state of affairs that compels them to supply . . . electric companies with long-term credit in amounts that may sometimes seem minuscule on a per capita basis to the affluent but that are almost always material to the poor and to those who are just getting by cannot be viewed complacently.").

The Company has also raised concerns about the impact of the EDIT flowback on its cash flow, which it speculates could negatively impact its credit metrics. (Tr. Vol. 5, pp. 67-83.) While the Commission acknowledges the concerns raised by DEC, as well as the benefits that ratepayers derive from the Company's strong credit profile, the Commission does not find the Company's evidence on this point compelling or convincing.

The Company's witness De May expresses his generalized concerns about the Company's credit metrics and references a Moody's Credit Opinion stating that a factor that could lead to a ratings downgrade would be if the FFO/Debt ratio fell below 25% on a sustained basis. (Tr. Vol. 4, p. 436.) Witness De May further discussed his analysis of the Public Staff proposal—which was, at that time, to return unprotected EDIT over two years—which indicated that the Public Staff two-year proposal would cause DEC's FFO/Debt ratio to fall below 25% for the first three years of a five-year forecast. (Id.; see also Tr. Vol. 22, p. 267, at Ex. JRH-3 (Hinton); and De May Confidential FFO/Debt Exhibit, at Schedule 1-1.) However, when projections of the Public Staff's current five-year flowback proposal are reviewed, they suggest much more modest deviations from the 25% cited by witness De May (Tr. Vol. 22, p. pp. 266-276, Confidential Ex. JRH-2.) Moreover, the Commission notes that the Company's FFO/Debt ratio projections are dependent on assumptions regarding cash flow which are dependent on a range of factors, including the outcome of this rate case, and the Company has not made available information relating its underlying assumptions regarding funds flow from operations. (Id., at 266.)

Moreover, the Commission further notes that the Company's concerns over cash flow and credit metrics are mitigated, to an extent, by the Public Staff's five-year flowback proposal, which provides the Company with the benefit of removing the total amount of the unprotected EDIT credit from the rate base in the current case, which benefits the Company by increasing rates and thereby moderating any cash flow issues, to the extent they might arise. The financing cost to the Company will be imposed ratably over the period that the EDIT is returned through the levelized rider.

Finally, the Commission concludes that DEC's proposal to offset the reduction in its revenue requirement resulting from the FTCJA with $200 million in accelerated depreciation expense is not sufficiently supported in the record and raises significant legal and practical concerns. A decline in revenues resulting from a change in federal tax law does not, by itself, support the adopting of offsetting revenue increases where those increases are not independently justified and supported. Here, aside from the desire to offset reductions resulting from the change in tax law, the Company has not offered any principled explanation of the need for accelerated depreciation nor has it offered any basis for applying special depreciation rates for particular assets. The Company does articulate concerns about adverse rate impacts on consumers, but, as discussed above, the Commission has adopted a five-year return of EDIT which will help ameliorate adverse impacts resulting from the return of EDIT. Moreover, as to DEC's credit metrics, record evidence suggests that DEC's projected FFO/Debt ratios, adjusted to eliminate the required for an additional $200 million in cash flow, will not jeopardize the Company's credit metrics. (Tr. Vol. 26, p. 514.) Instead, evidence suggests that DEC will be on track to maintain, or even exceed, its stated FFO/Debt ratio goal after implementation of federal tax reform without an annual $200 million revenue increase. (Id.)

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 15-17 [LEE NUCLEAR STATION]

The evidence supporting these findings and conclusions is contained in the filing of the parties and orders of the Commission in Docket No. E-7, Sub 819, the testimony and exhibits of Company witnesses Fallon, Diaz, and McManeus, Public Staff witnesses Metz, Maness, and Boswell, and Tech Customers witness Kee.

The Company asks the Commission to (1) approve DEC's decision to cancel the William S. Lee Nuclear Generating Station ("Lee Nuclear") project and (2) allow DEC to recover the North Carolina retail allocable share of approximately $542 million, amortized over 12 years, including a return on the unamortized balance. The Public Staff argues that the Company should be allowed to amortize its actual costs, with no return allowed on the unamortized portion and proposes one adjustment to remove DEC's claimed costs associated with a planned visitor center. DEC has accepted this adjustment. The Tech Customers support the Public Staff's position regarding the disallowance of a return on the unamortized portion of permitted costs, but assert that certain costs sought to be recovered by DEC are simply not recoverable. Most of these are those costs incurred after January 1, 2011, and not shown by the Company to have been incurred in an effort to maintain the "status quo" and those in excess of the cap imposed by the Commission of the North Carolina allocable portion of $120 million. Finally, the Tech Customers recommend that the Commission exercise its prudential authority and disallow certain AFUDC and/or other costs in view of the circumstances presented here.

Summary of Testimony

Witnesses Fallon and Diaz offer direct and rebuttal testimony in support of the Company's requests relating to the Lee Nuclear project.

Witness Fallon provides background on the Lee Nuclear project development activities and cost submitted for recovery from ratepayers in this proceeding. He discusses the licensing process utilized for the project, various challenges faced by the Company during the licensing process, and the Company's activities associated with obtaining a COL from the NRC. Witness Fallon discusses the Company's various requests to the Commission filed in Docket E-7, Sub 819 for approval to incur project development costs, as well as the Commission's various orders responding to the requests. Specifically, witness Fallon notes that the Commission issued an orders (1) dated March 20, 2007, approving DEC's decision to incur project development costs up to $125 million[8] through December 31, 2007; (2) dated June 11, 2008, approving DEC's decision to incur project development cost up to $160 million for the period January 1, 2008 through December 31, 2009; and (3) dated August 5, 2011, denying the authority sought by the Company but approving a decision to incur additional costs after January 1, 2011, subject to a not-to-exceed cap of $120 million and subject to the proviso that its approval was limited to those nuclear project development costs that must be incurred to maintain the status quo with respect to the Lee Nuclear project, including DEC's COL application at the NRC. (Tr. Vol. 10, pp. 187-192.) Mr. Fallon notes that the Company exceeded the "preauthorized" level of spending approved in the August 2011 order, but contends that those excess costs were outside the control of the Company and confined to activities necessary to maintain the status quo, which he identifies as "those activities and costs necessary to preserve the option of bringing the plant online around the 2021 target date." (Id., at 208.) Witness Fallon further reviewed the categories of costs sought to be

[8] References herein to Lee Nuclear costs are to total project costs, not separated by state jurisdiction.

recovered from ratepayers in connection with the Lee Nuclear project and offered his opinion that those costs were reasonably and prudently incurred. (Id., at 201-209.)

On cross-examination, Mr. Fallon conceded that the Company was seeking approximately 170% more than the not-to-exceed cap established by the Commission in the 2011 Order in this proceeding. (Tr. Vol. 11, p. 47.) He also agreed that, given the magnitude of expenses potentially involved with the project, it was appropriate for the Commission to keep a "watchful eye" on DEC's expenditures for the project. (Tr. Vol. 11, p. 39.)

Witness Diaz testified generally concerning the reasonableness and prudence of the strategy and efforts of DEC to obtain a COL for the Lee Nuclear project. (Tr. Vol. 10, p. 220.) Witness Diaz describes the steps taken by DEC to obtain a COL for Lee Station and the challenges it faced in obtaining the license. He offers the opinion that DEC acted reasonably and prudently in pursuing the COL. He also compares the recovery sought by DEC here with other nuclear projects and concludes, based on his review of summary cost information, that the costs sought are reasonable and prudent. (Id., at 249, 253.)

On cross-examination, witness Diaz clarified that he has never served on a state public service commission (Tr. Vol. 11, at 30), he was not holding himself out as an expert on North Carolina utility regulatory law (Id., at 32), nor was he testifying as an expert on utility ratemaking (Id.,, at 33). In this regard, it is evident that Mr. Diaz's testimony was confined to his expertise with respect to nuclear regulatory issues, especially regarding NRC licensing requirements and procedures. He also conceded that to the extent the Commission's orders in the Sub 819 docket conditioned the approval of DEC's decision to incur costs, he was not questioning those orders. (Id., at 34).

Public Staff witness Boswell proposes that the unamortized balance of the Lee Nuclear costs should be removed from rate base so that the Company does not earn a return on these costs. She explains that this proposal is consistent with Commission policy with regards to abandoned plant that that the recommendation has the effect of effecting equitable sharing of the loss between the utility and the customer.

Public Staff witness Maness proposes removal of the estimated 2018 AFUDC for the Lee project from the calculation of project development costs proposed for authorization in this case. (Tr. Vol. 22, pp. 99-101.) In support of this adjustment, Mr. Maness cites a FERC Accounting Release advising that AFUDC accruals should cease when construction is interrupted or suspended, unless the company can justify the interruption as being reasonable under the circumstances. (Id., at 101.) Based on the filings of the Company, Mr. Maness opines that substantive work on the project ceased no later than December 31, 2017, and that, accordingly, AFUDC should no longer accrue as of that date. (Id., at 102.) The Company has agreed to this adjustment. (Tr. Vol. 24, p. 33.)

Public Staff witness Metz proposes removal of certain costs related to the construction of a visitors center at the Lee site. (Tr. Vol. 11, p. 41.) The Company has agreed to this adjustment. (Id.) On cross-examination, Mr. Metz confirmed that the basis of his recommendation for disallowance was the Public Staff's position that the specified expenses were not authorized by the Commission's 2011 Order. (Tr. Vol. 23, p. 44.)

The Tech Customers witness Kee assesses the costs incurred and activities undertaken by DEC in connection with the Lee Nuclear project, particularly focusing on how those costs and activities align with the prior orders of this Commission relating to the project. As a framework for his review, witness Kee reviews the Commission's orders in Docket No. E-7, Sub 819, adopting "not-to-exceed" spending caps for the project and interprets these orders as providing controlling guidance for significant portions of the costs that DEC seeks to recover in this proceeding. (Tr. Vol. 18, pp. 163-174.) Witness Kee contends that, as a starting point, DEC should not be permitted to recover more than its actual spending (including AFUDC) corresponding to the recovery periods set out in each order, subject to the applicable not-to-exceed caps. (Tr. Vol. 18, p. 177.)

As to costs for the period prior to December 31, 2009, Mr. Kee calculates the total amount that the Company should be permitted to recover as the North Carolina allocable share of $172,002,979, including AFUDC. (Tr. Vol. 18, p. 43.) This calculation is based on the Company's submitted costs, without adjustment.

As to costs for the year 2010, Mr. Kee notes that DEC did not seek prior authorization for expenditures for 2010, and its request for retroactive approval of its 2010 expenses was rejected by the Commission in its 2011 Order. (Id., at 166.) Given this, Mr. Kee interprets this denial as a substantive determination by the Commission to deny permission to incur such cost, in the same manner as the Commission's other orders addressing prospective costs. Based on this, Mr. Kee states that recovery should not be permitted for costs corresponding to this time period. (Id., at 178).

As to costs arising in the post-2010 recovery period, Mr. Kee notes that the Commission's 2011 Order authorizes DEC only to incur costs necessary to maintain the "status quo." (Tr. Vol. 18, p. 171.) Mr. Kee notes that this limitation is a significant departure from the Commission's prior orders and should be construed to distinguish between those activities necessary to preserve the work that had already been done from other activities that go beyond the minimum necessary to maintain the status quo, including activities to obtain approval of the COL and activities related to preparation for the actual construction and operation of the project. (Tr. Vol. 18, pp. 174-175.)

Applying the limitations of the Commission's 2011 Order, witness Kee further contends that a significant portion of the costs claimed by DEC and relating to the period covered by the 2011 Order are not related to maintaining the status quo and, therefore, they should not be recovered. (Tr. Vol. 18, pp. 178.) Witness Kee further notes that DEC has not specifically identified those costs relating to maintenance of the status quo, presenting an evidentiary problem for it and the Commission. (Tr. Vol. 18, pp. 179.) Mr. Kee notes that, given this deficiency, the Commission might reasonable deny all recovery for this period as DEC has not demonstrated, as required under the Commission's order and G.S. 62-110.7, that such costs were reasonably and prudently incurred; alternatively, Mr. Kee offers a method of approximating DEC's costs incurred in connection with status quo activities based on grouping of DEC's claimed costs into broad categories. (Id.) Based on this approximation, Mr. Kee concludes that, at most, the North Carolina allocable share of $73,111,397, without AFUDC, could be regarded as expenses associated with maintenance of the "status quo." (Id.)

As to DEC's decision to incur project development costs, witness Kee observes that the Lee Nuclear project COL application status quo as of 2011 could have been maintained without much, or all, of the spending incurred by DEC, if DEC had taken a different approach to reduce this spending, including suspension of the Lee nuclear project COL application like many other similar projects during this general time period (Id., at197) or withdrawing the application and pursuing an Early Site Permit (Id., at 199). Finally, witness Kee takes the position that DEC's witness Diaz has overvalued the approved COL to DEC. Mr. Kee points out that the more time that passes between grant and construction (if DEC decides to construct) the more time and money will be needed to modify the COL and obtain approvals for the modifications. Moreover, if DEC were to decide to build at a different site, the COL would have little value. (Id., at 203-204.)

DEC did not cross-examine Mr. Kee.

In Rebuttal Testimony, witness Fallon argues that the Company should be permitted to earn a return on the unamortized portion of its project costs because it has obtained a COL which would permit it to construct a nuclear facility in the future should the Company's plans change. (Tr. Vol. 24, p.37-38.) Witness Fallon also offers rebuttal to the testimony of Mr. Kee, stating that the not-to-exceed caps in the Commission's prior orders should not be read to limit DEC from recovering costs "that are incurred outside the orders." (Tr. Vol. 24, p. 41.) Witness Fallon also takes issue with Mr. Kee's interpretation of the "status quo" requirement, reiterating the Company's view that the limitation authorized recovery of costs associated with activities necessary to preserve the option of bringing the Lee Nuclear Project online around the target date. (Tr. Vol. 24, p. 44.)

In Rebuttal Testimony that was stipulated by the parties into evidence without cross-examination, witness Diaz disagrees with witness Kee's efforts to distinguish between various categories of costs claims by DEC and states that the

Lee COL could not have been obtained without exceeding the Commission's cap on spending. (Tr. Vol. 26, pp. 181-182.) With regards to the benefits of pursuing the license versus suspending the application, witness Diaz states that that the COL provides greater certainty with regards to the ability to build the project (Id., at 183) and he emphasizes that no changes or revisions to the specified licensing condition to proceed with construction in the future. (Id., at 185.) Witness Diaz also testifies that the COL remains a valuable asset to DEC. (Id., at 187.)

Discussion

1. Approval of Cancellation of Project

The Company asks the Commission to "approve" its decision to terminate the Lee Nuclear project. See Request for Approval to Cancel the Lee Nuclear project, Docket No. E-7, Sub 819 (Aug. 25, 207). DEC cites G.S. 62-110.7(d) as the sole basis for this request. (Tr. Vol. 10, at 198; Tr. Vol. 11 at 69.) This statute provides: "If the public utility is allowed to cancel the project, the Commission shall permit the public utility to recover all reasonable and prudently incurred project development costs in a general rate case proceeding pursuant to G.S. 62-133 amortized over a period equal to the period during which the costs were incurred, or five years, whichever is greater." G.S. 62-110.7(d).

G.S. 62-110.7(d) does not require the Commission to approve cancellation of a project where that approval is not otherwise required under Chapter 62. Instead, the statute is directed to the recovery of project development costs in a general rate case in circumstances where the utility is allowed to cancel the project. Because the provision does not address under what circumstances the Commission may or should approve cancellation of a project, that authority must come from elsewhere.

The Commission is not aware of any provision of Chapter 62 which would require it to approve the Company's decision to cancel the project under the circumstances presented here, and the Company has not identified any such provision. The uncontested facts are that DEC has not applied for or received a certificate of public convenience and necessity (or a Certificate of Environmental Compatibility and Public Convenience and Necessity under South Carolina law); the Commission has not granted any authority to construct the project; and the Commission has not approved any specific plans, whether design, technical, or otherwise. Given that the only authorization in issue is the authorization to incur project development costs, DEC's decision to terminate the project is an internal business decision. *Compare* G.S. 62-110.1(e) (requiring Commission approval to cancel construction of a generating unit after issuance of a CPCN) *with* G.S. 62-110.7(d) (permitting recovery of "all reasonable and prudently incurred costs" if the utility is allowed to cancel the project). The Commission has not been delegated authority to review, approve, or disapprove DEC's decision to cancel the development of a hypothetical project and any attempt to do so would be without legal effect.

The language of G.S. 62-110.7 is not a model of clarity, but, when it is read in context, it is apparent that subsection (c) of this statute applies when the project in issue has been constructed and subsection (d) applies when the Commission or the utilities commission of another state has authorized the project in issue. This reading is consistent with the structure of the parallel provisions in G.S. 62-110.1(f2) and (f3), which address recovery of construction costs upon the cancellation of a facility's construction, which requires Commission approval under G.S. 62-110.1(e); and with G.S. 62-110.6(e), when cancellation would require the approval of another state's utilities commission. DEC never advanced the Lee Nuclear project far enough to obtain any utilities commission approval to construct it, and it does not need any commission's approval to cancel it.

Although the Commission, for the reasons discussed above, will not entertain the Company's invitation to "approve" its decision to cancel the Lee Nuclear project, the Commission notes that no party opposes the Company's decision or otherwise argues that the Company's decision was unreasonable, imprudent or otherwise inappropriate.

2. Cost Recovery

The Tech Customers' arguments raise primarily legal issues and require consideration of the various orders issued by the Commission in the Sub 819 docket together with G.S. 62-110.7, which authorizes a utility to seek approval of a decision to incur nuclear project development costs prior to filing an application for a certificate to construct. Generally, both witness Fallon and witness Kee accurately describe the findings and conclusions of the Commission's prior orders (see Tr. Vol. 10, pp. 186-191 (Fallon) and Tr. Vol. 18, pp. 163-172(Kee)), but they differ greatly in their interpretation of the effect of those orders.

The Company interprets the orders as approving the Company's decision to incur project development costs, but concludes that the express limitations set forth in the orders do not preclude recovery of costs outside these limitations. (Tr. Vol. 24, p. 41.) In other words, under the Company's interpretation the Commission's adoption of a spending cap did not prohibit the Company from spending in excess of the cap and it did not prohibit the Company from recovering the excess above the cap from ratepayers. By contrast, the Tech Customers interpret the limitations of the orders as precluding recovery of costs that are outside the limitations established by the Commission.

This dispute concerning whether the Commission's orders "mean what they say" presents an issue of first impression for the Commission. Based on the arguments of the parties and the record as a whole, the Commission concludes that the Company's interpretation of the Commission's orders is not supportable and is inconsistent with the language of G.S. 62-110.7(b).

G.S. 62-110.7(b) provides as follows:

> At any time prior to the filing of an application for a certificate to construct a potential nuclear electric generating facility, either under G.S. 62-110.1 or in another state for a facility to serve North Carolina retail customers, a public utility may request that the Commission review the public utility's decision to incur project development costs. The public utility shall include with its request such information and documentation as is necessary to support approval of the decision to incur proposed project development costs. The Commission shall hold a hearing regarding the request. The Commission shall issue an order within 180 days after the public utility files its request. The Commission shall approve the public utility's decision to incur project development costs if the public utility demonstrates by a preponderance of evidence that the decision to incur project development costs is reasonable and prudent; provided, however, the Commission shall not rule on the reasonableness or prudence of specific project development activities or recoverability of specific items of cost. (emphasis added)

Under this provision, the Commission is required to approve a utility's decision to incur project development costs if the utility demonstrates by a preponderance of the evidence that the decision to incur project development costs is reasonable and prudent. By inference, the Commission's only basis for denying a request for approval would be a conclusion that the utility had not carried its burden to demonstrate that the decision to incur project development costs was reasonable and prudent. Stated another way, a denial under this provision fairly implies the conclusion that the decision to incur the costs in question is not reasonable or prudent.[9]

In its 2011 Order, the Commission expressly denied the Company's request for approval under G.S. 62-110.7(b). The basis for this denial was the Commission's conclusion that the Company had not carried its burden of

[9] To the extent the Company is contending that a "decision to incur costs" is different from the "act of incurring those costs," the Commission perceives no practical difference between an imprudent decision to incur costs and the act of actually incurring the costs.

persuasion and, therefore, only a decision to incur costs consistent with the limitations of the order would be approved as “reasonable and prudent.” The interpretation is supported by the express findings of the Commission with respect to the multiple and serious questions about the prudence of continuing down the path the Company was on, coupled with DEC’s statement that it had no present intention to construct the facility in the absence of CWIP legislation.[10] This interpretation is further supported by the express language of the Commission’s 2008 Order, where the Commission found that: “Duke’s decision to incur project development costs is approved subject to the following: the maximum amount of project development costs to be incurred on and after January 1, 2008, that are deemed to be included in a reasonable and prudent decision to incur project development costs is the North Carolina allocable share of a total system amount of $160 million ….” Order Approving Decision to Incur Project Development Costs, Docket No. E-7, Sub 819 (June 11, 2008) (emphasis added). The Commission believes that, although the language is not identical between the 2008 and 2011 Orders, the reasoning and interpretation of the effect of the orders was identical.

Having previously found—based on the evidence presented by the parties—that limitations should be imposed on a reasonable and prudent decision to incur project development costs, the Commission sees no basis under G.S. 62-110.7 or otherwise under the law to permit recovery of costs outside these limitations. To do so would be to permit the recovery of unreasonable and imprudent costs—which is beyond this Commission’s authority. It would also constitute exactly the sort of “second guessing” that the Company has opposed and which the statute was designed to prevent.

Moreover, the Company’s interpretation has the effect of nullifying any limitation imposed by the Commission in an order under G.S. 62-110.7(b). Under DEC’s reading, if the Commission had simply denied DEC’s request for approval in its 2011 Order, DEC could have nonetheless proceeded as it did and still presented ratepayers a bill for the $500 million in development costs. This makes a mockery out of the Commission’s regulatory process and cannot be what the General Assembly envisioned when it established the statutory approval process. The Company has not, to date, challenged the Commission’s authority to condition approval under that statute, and there is nothing on the face of the statute that suggests that the Commission is without authority to exercise its inherent regulatory powers and authority in considering and disposing of requests under the statute. The Commission’s oversight of a decision to incur project development costs benefits the company by providing protection against future challenges of

[10] This latter point was a matter of considerable significance to the Commission. There is no indication from the Commission’s orders that it understood the Company’s intention was to “bank” the COL and pursue construction if and when the Company thought it appropriate to construct in the future. If the Company had informed the Commission of this plan, the Commission would have been in a position to investigate this plan and ensure that the interests of the company and ratepayers were protected.

the reasonableness and prudence of the decision while at the same time helping to protect ratepayers by giving the Commission an opportunity to provide regulatory guidance at the project development stage.

While the Commission agrees with the Company that G.S. 62-110.7(b) is a permissive, not mandatory, provision, that is of no moment here. The Company was not required to seek prior approval of its decision to incur project development costs. But having done so, it must live with the consequences, including conditions the Commission imposed on its approval. Such a result does not leave the utility without options. DEC could have sought additional authority, it could have sought reconsideration of the Commission's order, or it could have sought judicial review of the Commission's determination—yet it did not pursue any of these options. From the evidence in the record, it is apparent that the Company was aware of the risks associated with its course of action, including the risk that the Commission might deny cost recovery, and made decisions with appreciation of these risks.

The Commission's determination that its orders "mean what they say" is particularly significant here given that the 2011 Order limits post-January 2011 costs to those necessary to maintain the status quo. The Company argues that "status quo" referred to the Company's efforts to bring the nuclear facility online in accordance with the projections of its IRPs. This interpretation, however, does not constitute a limitation—it merely defines the scope of the project the Company was undertaking prior to the 2011 Order. The phrase "status quo" is a well-known term with a readily understood meaning—maintaining the current status of affairs. It expressly does not intend to convey the party subject the requirements should continue engaging in the activities or conduct that the party was engaging in prior to the order—<u>it means the opposite</u>. If the Commission had intended that DEC would just keep doing what it was doing it would not have imposed the limitation. Instead, it is quite evident from the order that the Commission was concerned with the status of the project and the level of expense being incurred, and that the 2011 Order was intended to rein in both the scope of the activities undertaken and the magnitude of costs incurred.

The Company's disregard of this limitation presents a practical, evidentiary problem in this proceeding. DEC has not presented any evidence showing that the costs it is now claiming for the period after January 1, 2011 were necessary to maintain the status quo. The Company is entitled to recover its project development costs in this proceeding if demonstrates that its costs were reasonably and prudently incurred. As discussed above, the Company can only make that showing here if it demonstrates that the costs claimed were incurred consistently with the limitations of the 2011 Order. The statements of the Company's witnesses that the costs were incurred to maintain the status quo are entitled to no weight as the Company has made no effort to apply a plausible interpretation of the limitation. The Company's concession that the expenses associated with the visitors center should be denied is only one illustration of the problem. Similarly, the Public Staff's review of the Company's cost is also no help on this particular point as it is apparent that the Public Staff relied on the review of its consultant, and the consultant accepted the Company's incorrect interpretation of status quo. (Tr. Vol. 23, p. 15, Ex. 6 at p. 5 ("The Order of the NCUC appears to indicate that the Commission found it appropriate for DEC to continue on its current trajectory of pursuing the COL from the NRC.")).[11]

With this background, the Commission reaches the following specific conclusions with regards to the recovery of costs sought be DEC.

(1) DEC should only be allowed to recover the North Carolina allocable share of its actual costs, including AFUDC, incurred in the period up to December 31, 2009, if those actual costs are less than the not-to-exceed limits in the 2007 Order and the 2008 Order. Based upon the evidence in the record, the Commission concludes that the Company should be permitted to recover the North Carolina allocable share of $172,002,979, including AFUDC, corresponding to the period prior to December 31, 2009.

(2) DEC should only be allowed to recover costs of the Lee Nuclear project after January 1, 2011, to the extent those costs were clearly required to maintain the status quo and if those costs did not exceed the not-to-exceed cap of the North Carolina allocable share of $120 million, including AFUDC. Given DEC's failure to submit evidence which would allow the Commission to verify "status quo" expenditures, the Commission concludes that it is appropriate to deny recovery for costs incurred during this period as the Company has not carried its burden of demonstrating that such costs were reasonably and prudently incurred.[12]

(3) DEC's costs incurred in 2010 were denied in the 2011 Order and, therefore, are not recoverable.

<u>3. Return on unamortized portion</u>

Based on review of all the evidence in the record, the Commission concludes that DEC should not be allowed to earn a return on the unamortized portion of the approved Lee Nuclear project costs.

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[11] In any event, the consultant's report was not admitted into evidence for the "truth of the matter asserted" (Tr. Vol. 23, p. 15), so that report cannot form the basis for a conclusion that DEC's post January 2011 were compliance with the limitations of the 2011 Order.

[12] **[*ALTERNATIVE*]** The Commission concludes that it is appropriate to allow only the costs during this period most closely identified with maintenance of the "status quo," which is the North Carolina allocable share of $73,111,397 without AFUDC.

The Commission agrees with the position of the Public Staff that this approach has the benefit of effectively "sharing" the costs of abandonment between DEC shareholders and ratepayers and is consistent with past Commission practice and the law. Moreover, because the Lee Nuclear project has been canceled by DEC, there are no "used and useful" assets that would justify granting DEC a return. See G.S. 62-133(b)(4). Given this concern, the Commission has in prior cases found it more appropriate to treat costs associated with abandoned or terminated projects as operating expenses, for which no return is allowed. G.S. 62-133(b)(5). DEC has presented no compelling case for a reversal of this policy.[13]

The Commission has a longstanding and consistent approach to the treatment of costs associated with abandoned and terminated projects, including the, including in the specific context of abandoned nuclear plant costs. State ex rel. Utilities Comm'n v. Thornburg, 325 N.C. 463, 467 n.2, 480, 385 S.E.2d 451, 453 n.2, 460-61 (1989) (concluding that "recovery from ratepayer and shareholders through amortization of costs in rates over a period of years, with no return on the unamortized balance," is "the best" way to handle nuclear abandonment losses "in that it promotes an equitable sharing of the loss between ratepayers and the utility stockholders," and upholding such equitable sharing (quotation omitted)); see, e.g., Order Approving Request for Deferral Accounting, Docket No. E-2, Sub 1035, at 3-4 (Sept. 16, 2013) (DEP proposal for deferral accounting as to Units 2 and 3 of Harris Nuclear Station does not include any return on the unamortized balance "consistent with the case law in this State"); Re Carolina Power & Light Co., Docket No. E-2, Sub 461, 55 P.U.R.4th 582 (Sept. 19, 1983) ("The company should be allowed to recover its abandonment loss sustained as the result of the company having terminated construction on, and having abandoned, its Shearon Harris Nuclear Units Nos. 3 and 4. . .. It is neither fair nor reasonable to include any portion of the unamortized balance of this investment in rate base, and no adjustment which would have the effect of allowing the company to earn a return on the unamortized balance of this investment should be ordered."); Re Carolina Power & Light Co., Docket No. E-2, Sub 444, 49 P.U.R.4th 188 (Sept. 24, 1982) ("The first area of difference concerns the unamortized Harris Units 3 and 4 loss amount. Based on the commission's Finding of Fact No. 11, the commission has not included the $53,748,000 unamortized loss in rate base."); see also State ex rel. Utilities Comm'n v. Carolina Water Serv., Inc., 335 N.C. 493, 508, 439 S.E.2d 127, 135 (1994) ("If facilities are not used and useful, they cannot be included in rate base. Including costs in rate base allows the company to earn a return on its investment at the expense of the ratepayers. We do not allow such a return for property that will not be used or useful within the

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[13] To the extent that DEC relies on G.S. 62-110.7(d), the Commission concludes that that subsection does not apply in this proceeding for the reasons stated herein. In any event, that subsection provides only that DEC can "recover all . . . costs," not that it may earn a return on those costs, as conceded by DEC's witness Fallon. (Tr. Vol. 24, pp. 70-71.)

near future. Costs for abandoned property may be recovered as operating expenses through amortization, but a return on the investment may not be recovered by including the unamortized portion of the property in rate base." (citations omitted)); Re Pub. Serv. Co. of N. Carolina, Docket No. G-5, Sub 32, 33 P.U.R.3d 398 (Apr. 8, 1960) ("The company proposes that the unamortized balances be included in its rate base for purposes of earning a return on these balances. We shall not accept the company's position for the reason that it cannot under any circumstances be said to be a part of Public Service's property presently used and useful in rendering service.").

DEC argues that the issuance of COL for the Lee Nuclear project differentiates this request from other previous requests, but the Commission does not perceive any meaningful distinction created by this fact, and DEC has failed to articulate any principled basis for departing from this established precedent under the present circumstances. The fact that DEC has obtained a COL does not alter the Commission's analysis, given that the existence of the COL will not be used and useful within the near future and is, at most, an asset held for future use. The critical component in this consideration is not whether or not the activities in issue were subject to a license or certificate, but whether the activities resulted in the establishment of assets which are used and useful. Here, DEC has incurred project development costs in pursuit of a project that has not come to fruition. The Commission will permit recovery of DEC's reasonably and prudently incurred costs, but there is no basis for allowing DEC to earn a return on costs have not resulted in productive assets for ratepayers. Moreover, the Commission's policy has the effect of resulting in a sharing of expenses as between ratepayers and investors, which the Commission concludes is reasonable and appropriate under these circumstances.

4. AFUDC

The Public Staff and DEC have reached agreement that the Company should not be entitled to receive AFUDC based on 2018 cost projections, on the basis that AFUDC should not be accrued after work is stopped on the project. (Tr. Vol. 22, pp. 99-10; Tr. Vol. 24, p. 33.) The Tech Customers raise an additional issue, however, relating to recovery of AFUDC which is an amplification of the issue identified by the Public Staff and conceded by the Company—the Tech Customers contend that the period of effective project abandonment dates back to the time of the 2011 Order and that, therefore, AFUDC should not be recovered from ratepayers from and after that date.

Much of the Lee Nuclear project development costs DEC seeks to recover consists of allowance for funds used during construction ("AFUDC"). In fact, for the period after January 1, 2011, more than half of DEC's costs—approximately $193 million—consists of AFUDC. See Tech Customers Testimony of Ed Kee, Table 3.

While a utility typically is entitled to recover AFUDC on funds reasonably and prudently spent on construction, this Commission in its 2011 Order very clearly regarded DEC's continued pursuit of the Lee Nuclear project as being dubious. DEC should not be allowed to transform its delay in formally announcing cancellation of the project—even as the prospect for nuclear power development deteriorated to the point where DEC was forced to admit the project was not in the public interest—into a source of revenue at the expense of ratepayers. Such a result would encourage DEC to pursue risky ventures in the future that could not be justified if DEC operated in a competitive market. Furthermore, the Commission noted in rejecting Duke Power Company's request for a return on the unamortized costs of its cancelled Perkins nuclear generating unit as "unfair," AFDUC exceeding actual costs "tends to indicate that extended periods of time elapsed with no appreciable . . . activity." In re Duke Power Co., Docket No. E-7 Sub 338, 49 P.U.R.4th 483 (Nov. 1, 1982).

Moreover, it is generally recognized that AFUDC should not be recovered from ratepayers after the point in time that a project has been abandoned. *See, e.g.,* 18 C.F.R. Part 101 ("No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.") (Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to Provisions of the Federal Power Act); Order Ruling on Petition, Docket No. E-2, Sub 913, 2008 N.C. PUC LEXIS 709 (June 4, 2008) (GridSouth Order) (holding Progress Energy Carolinas would not be permitted to recover carrying costs on deferred accounting relating to the abandoned GridSouth RTO formation project after the date that RTO formation efforts were abandoned, as determined by the Commission).[14] The Lee Nuclear Project ceased being a "potential nuclear electric generating facility" when DEC decided it was only pursuing an option, not actual development of a facility. While it may make sense for ratepayers to pay carrying costs while activity is being conducted that could—and is intended to—result in used and useful assets for the benefit of ratepayers, once a project has been abandoned the justification for passing AFUDC on to ratepayers goes away.

Here, review of the 2011 Order coupled with consideration of evidence presented of the Company's internal deliberations compels the conclusion that DEC had no present intent to construct the Lee Nuclear project—i.e., it was effectively "abandoned"—as of the date of the 2011 Order. Duke Energy's President testified to this point directly at the hearing in connection with the 2011

[14] AFUDC also should not be allowed to accrue while the utility ponders, but does not actually pursue, development of a project. See Columbus S. Power Co. v. Pub. Util. Comm., 67 Ohio St. 3d 535, 534-35 & n.4, 620 N.E.2d 835, 842-43 & n.4 (1993) (appropriate not to allow AFUDC when decision to move forward on construction not made). Also see Fla. Gas Transmission Co., 130 FERC ¶ 61,194, 61,860 (Mar. 18, 2010) ("[I]f a [utility] suspends substantially all activities related to the construction of [utility] facilities, AFUDC accruals must cease unless the company can justify the interruption as being reasonable under the circumstances.").

Order, stating that DEC would not construct the project without CWIP legislation and that that there was no such legislation proposed, much less passed, as of that time. This testimony was the linchpin of the 2011 Order, as the Commission took DEC at its word that construction of the project had, for all practical purposes, been abandoned as of that date.

In any event, it is evident that DEC made the decision to "bank" the COL rather than proceed to construction sometime well in advance of its formal declaration to the public that it was terminating the project. A 2013 presentation to senior management discussed several options as to Lee Nuclear, including:

1) Continue with COL but file no more cost approval proceedings with NCUC and either (a) build Lee "shortly after COL" or (b) "Terminate Lee project after receipt of COL"
2) Continue with COL and file cost approval proceeding and either (a) "maintain current position and strategy regarding NC CWIP legislation" (b) change CWIP legislation position and try to use existing CWIP law or (c) publicly announce intent to pursue CWIP legislation in 2015; or
3) Suspend Lee COL application.

Public Staff Fallon Rebuttal Cross Examination Exhibit 2, at 7 (Tr. Vol. 24, pp. 68-70). It was recommended to senior management that DEC continue without a cost approval proceeding (option 1) and pursue 2015 CWIP legislation. *Id.*, at 8. As events bore out, it is clear DEC elected option 1(b). A June 24-25, 2015, Board of Directors presentation discusses the "decision framework" for Lee and recommends: "Obtain and hold license" as a "hedge to respond to signpost outcomes (i.e., inability to relicense Occonee, gas prices, load growth, carbon, solar penetration)". Tech Customers Fallon Cross Exhibit 1, Tab 10, at 8 (Tr. Vol. 11, pp. 67-69). These presentations establish that, after the decision in 2011 that DEC would not build Lee without CWIP legislation, DEC did not have the requisite intention to construct Lee, but rather was speculating on the value of the COL and the possibility of CWIP legislation. This lack of a decision to move forward to construct Lee justifies the disallowance of AFUDC.

On cross-examination, DEC's witness Fallon confirmed this change was tied to the Commission's 2011 Order. Mr. Fallon testified that, "Previous to this, our desire was, as soon as we got the COL, we were gonna go to the field and start construction. I think, after this order, you saw the change, and we slimmed down the project to do exactly what the Commission asked us to do in this order …." (Tr. Vol. 11, p. 54.) Setting aside the issue whether the Company in fact complied with the Commission's order, DEC's testimony confirms that, dating at least from the Commission's 2011 Order, the Company's strategy had changed from "construct as soon as possible" to "bank the COL and decide whether to construct at some undetermined point in the future."

In setting rates, the Commission has authority to consider all material facts to determine what ultimately constitute just and reasonable rates. G.S. 62-133(d). The Commission does not perceive a basis in policy to permit recovery of AFUDC corresponding to periods where the utility does not even contemplate initiation of construction project that might result in establishment of used and useful assets. Following the reasoning of the GridSouth Order, the Commission concludes that the Company should not be permitted to recover AFUDC accrued after August 5, 2011, the date of the 2011 Order, when the Commission made clear that it was taking DEC at its word that it had no present intent to construct Lee Nuclear project.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 12-17
[ROE]

The evidence supporting these findings and conclusions is contained in the verified Application and Form E-1 of the Company, the testimony and exhibits of the expert witnesses, and the entire record in this proceeding.

In its Application the Company requested approval for its rates to be set using a rate of return on equity of 10.75%. The Stipulation provides for a rate of return on equity of 9.9%, which is a decrease from the 10.2% level authorized by the Commission in the Company's last rate case.

DEC witness Hevert testified that his analysis (using the DCF, CAPM, and Bond Yield Plus Risk Premium approach, taking into consideration factors such as DEC's risks associated with environmental regulations, flotation costs, and the current uncertainty in the capital markets) indicated that the Company's ROE was in the range of 10.25% to 11.00%. Based on his quantitative and qualitative analyzes, including the risk profile of the Company, Mr. Hevert testified that 10.75% was a reasonable and appropriate estimate of DEC's ROE. (Tr. Vol. 4, pp. 100-101.)

Public Staff witness Parcell employed three recognized methodologies (DCF, CAPM, and CE) to estimate DEC's cost of equity, each of which he applied to two proxy groups of electric utilities. Based upon these findings, he concluded that DEC's cost of equity was within a range of 8.70 percent to 9.50 percent (9.1 percent mid-point), which was based upon the mid-point of his DCF results and mid-point of his CE results models. (Tr. Vol. 26, pp. 806-808.)

The Tech Customers' witness Strunk criticized Mr. Hevert's ROE analysis on several grounds. Witness Strunk noted that the relatively high equity ratio proposed by DEC should correspond to a lower ROE than that sought by DEC. He also testified that objective evidence demonstrates that DEC is less risky than the proxy group used by Mr. Hevert in his analysis, but that Mr. Hevert did not adjust his analysis to reflect these differing risk characteristics. Mr. Strunk outlined several empirical measures of risk in his testimony and the associated exhibits, and none suggests that DEC presents a higher risk profile than the proxy group companies. To the contrary, the objective evidence shows the opposite—that DEC is less risky than its peer group. Taken together, the objective credit and business risk ratings demonstrate that DEC presents *lower* financial risk to equity investors than the proxy group companies, which should result in a significantly lower ROE than that proposed by DEC. (Tr. Vol. 26, pp. 493-506.)

The NCAG's witness Woolridge applied the Discounted Cash Flow Model ("DCF") and the Capital Asset Pricing Model ("CAPM") to his proxy group of electric utilities. He also used Mr. Hevert's proxy group to conduct this analysis. His recommendation resulting from this analysis was that the appropriate ROE for the Company is 8.40%. This figure is at the upper end of his equity cost rate range of 7.9% to 8.40%. (Tr. Vol. 11, p. 99.)

CIGFUR III's witness Phillips testified that DEC's ROE should not exceed the national average for electric utilities, which is currently 9.63%, noting the, generally, market costs of capital have declined since DEC's last rate case. (Tr. Vol. 26, p. 273.)

CUCA witness O'Donnell relied on a DCF, Comparable Earnings and, to a limited extent, CAPM analyses in support of a ROE of 9.0%, as this result is at the top end of his DCF results, at the low-end of the range of results for the comparable earnings test, and is well above the CAPM results. (Tr. Vol. 18, pp. 74-92.)

Rate of return on equity, also referred to as the cost of equity capital, is often one of the most contentious issues to be addressed in a rate case, even in a case such as this one in which a Stipulation between the utility and the consumer advocate has been reached. In the absence of a settlement agreed to by all parties, the Commission must still exercise its independent judgment and arrive at its own independent conclusion as to all matters at issue, including the rate of return on equity. See, e.g., CUCA I, 348 N.C. at 466, 500 S.E.2d at 707. In order to reach an appropriate independent conclusion regarding the rate of return on equity, the Commission should evaluate the available evidence, particularly that presented by conflicting expert witnesses. State ex rel. Utils. Comm'n v. Attorney Gen. Roy Cooper, 366 N.C. 484, 739 S.E.2d 541, 546-47 (2013) (Cooper I). In this case, the evidence relating to the Company's cost of equity capital was presented by Company witness Hevert, Public Staff witness Parcell, Commercial Group witnesses Chriss and Rosa, AGO witness Wooldridge, CIGFUR witness Phillips, CUCA witness O'Donnell, and Tech Customers witness Strunk. No rate of return on equity expert evidence was presented by any other party.

In a fully contested rate case such as, for example, the 2012 DNCP rate case, there will almost inevitably be conflicting rate of return on equity expert testimony. Even in a partially settled case, the Commission may be faced with conflicting rate of return on equity expert witnesses whose testimony, in accordance with CUCA I and Cooper I, requires detailed consideration and, as necessary, evaluation by the Commission of competing methodologies, opinions, and recommendations. These were the circumstances in DEC's 2011 rate case, Docket No. E-7, Sub 989, which resulted in the Cooper I decision, as well as the DEP Sub 1023 Rate Case. In both of those cases rate of return on equity expert testimony from CUCA witness O'Donnell provided an alternate rate of return on equity analysis that pegged the utility's cost of capital at an amount lower than the settled rate of return on equity. The Supreme Court in Cooper I faulted the Commission for not making explicit its evaluation of this testimony, and, thus, the Commission in the 2013 DEP Rate Order made an express evaluation of witness O'Donnell's testimony in accordance with the Cooper I decision.

With this background, in reviewing the evidence submitting by the parties on the issue of ROE, the Commission notes substantial concerns with the Company's proposal.

In DEC's prior rate case four and a half years ago, the Commission approved a ROE of 10.2%, expressly relying on the empirical analysis DEC witness Robert Hevert offered in his testimony. In particular, the Commission gave "great weight" to witness Hevert's DCF analysis, "particularly as it relates to his findings concerning mean growth rates." Order Granting General Rate Increase, Docket No. E-7, Sub 1023, at 39 (Sept. 24, 2013). In this proceeding, despite a changed capital environment in which objective indictors show the cost of equity has declined since 2013, (see, e.g., Tr. Vol. 26, p. 273), Mr. Hevert advocated that the Commission *increase* DEC's ROE from 10.2% to 10.75%.[15]

The discounted cash flow ("DCF") empirical models used by Mr. Hevert—and particularly the models based on mean growth rates of the sort the Commission relied upon in DEC's previous rate case—were striking in their failure to support his recommended ROE. For example, the average of the mean results from Mr. Hevert's three DCF models stands at 8.65%, 210 basis points below his recommended ROE (and 130 basis points below the DEC-Public Staff stipulated ROE). See Tr. Vol. 4, pp. 404 (Table 11 to Hevert Rebuttal Testimony), 457; Tech Customers Hevert/DeMay Cross Examination Ex. 1 (Tech Hevert Ex. 1). In fact, the average ROE yielded by all the empirical models Mr. Hevert employed in his testimony is 9.61%, 114 basis points below his recommended ROE of 10.75% and 29 basis points below the DEC-Public Staff stipulated ROE of 9.9%. See Tr. Vol. 4, pp. 404, 458; Tech Hevert Ex. 1. Mr. Hevert acknowledged in his testimony that DCF models are widely used and recognized in rate proceedings like this one. See Tr. Vol. 1, p. 454; see also In the Matter of Application by 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, Docket No. E-22, Sub 532, Tr. Vol. 20, pp. 13–14.

[15] While the Public Staff and DEC presented to the Commission for its consideration a partial settlement, which includes a proposed stipulated ROE of 9.9%, Mr. Hevert testified that if the rate case were litigated, he would adhere to his recommended ROE of 10.75%. (Tr. Vol. 4, pp. 408–09.)

Given this gulf between Mr. Hevert's targeted ROE recommendation and the objective evidence at hand, it appears to the Commission that Mr. Hevert placed determinative reliance on the what he contended was DEC's higher risk profile, rather than his financial analysis models. Mr. Hevert testified that "[b]ecause it is important to reflect the results of different models, and the mean and mean low Constant Growth DCF results are far removed from recently authorized returns, I conclude that they should be given less weight than other methods in determining the Company's ROE." Tr. Vol. 4, pp. 124–25. Mr. Hevert went on to testify that, in his view, "it is appropriate to establish an ROE that is above the proxy group mean results" on account of DEC's "risk profile relative to the proxy group analytical results." (Tr. Vol. 4, p. 182.)

However, having abandoned the results of his empirical models, Mr. Hevert's resort to risk analysis is equally suspect. The objective evidence in the record refutes Mr. Hevert's premise that DEC presents a higher risk profile to equity investors than does the proxy group and therefore is entitled to an upward departure from the empirical models (and recently authorized ROEs) when the Commission sets its ROE. In fact, the objective evidence demonstrates the opposite—that DEC represents a decidedly *less risky* equity investment based on a host of empirical measures of risk. As a result, under the requirements of Hope and Bluefield, the ROE figure Mr. Hevert advances in his testimony is excessive.

In contrast to Mr. Hevert's testimony, the Tech Customers' witness Strunk outlined several empirical measures of risk in his testimony and the associated exhibits, and none suggest that DEC presents a higher risk profile than the proxy group companies. See Testimony of Kurt Strunk, pp. 40–41; Tech Customers Exs. KGS-5, KGS-6; Tr. Vol. 4, pp. 471–73. These ratings are the highest attained by any company within the proxy group, with all other companies but two having lower ratings from Moody's and all but five having lower ratings from Fitch. *See id*. Standard & Poor's Business Risk rating assigned to DEC's parent Duke Energy Corporation is "Excellent," the highest rating and higher than the holding company of nine members of the proxy group. See Testimony of Kurt Strunk, p. 41; Tech Customers Ex. KGS-7; Tr. Vol. 4, pp. 473–75. Significantly, Standard & Poor's Business Risk rating captures both credit and equity risk. (Tr. Vol. 4, pp. 474–75.) Standard & Poor's Financial Risk rating for Duke Energy Corporation places DEC squarely in line with the holdings companies of the proxy group from a risk standpoint – with all but two holding the "Significant" rating. See Testimony of Kurt Strunk, p. 41–42; Tech Customers Ex. KGS-8; Tr. Vol. 4, p. 475. Taken together, these credit and business risk ratings demonstrate that DEC presents *lower* financial risk to equity investors than the proxy group companies, not *higher* as Mr. Hevert contends. See Testimony of Kurt Strunk, p. 41–42.

At least two other objective measures of risk in the record support Mr. Strunk's testimony that DEC presents a lower risk profile than proxy group companies—and refute Mr. Hevert's position to the contrary. Value Line's estimated betas for each of the holdings companies of the proxy group are collected and depicted in the Tech Customers Hevert Cross Exhibit 3. Tr. Vol. 4, pp. 478–79; Tech Hevert Ex. 3. The beta for Duke Energy Corporation is 0.60, which is lower than all but one of the holding companies for the proxy group and is indicative of lower risk. *Id*. Likewise, DEC's equity ratio is among the highest in the proxy group, which is a further indicator that DEC presents a comparatively lower risk profile than the proxy group. Testimony of Kurt Strunk, pp. 39–40; Tech Customers Ex. KGS-4. Mr. Hevert acknowledged that equity ratio and risk are inversely proportional: as a company becomes more leveraged by decreasing its equity ratio, one would expect the ROE to increase because the increased risk to the equity investor. *See* Tr. Vol. 4, p. 485.

Mr. Hevert did not dispute any of these objective measures of risk, nor did he dispute that the ratings and values assigned to DEC and Duke Energy Corporation were generally more favorable than those assigned to companies in the proxy group or their holding companies. (Tr. Vol. 4, pp. 471–81.) He also did not contend that these measures suggest DEC has a higher risk profile. (<u>See, e.g.</u>, Tr. Vol. 4, p. 475.) Instead, he questioned whether these objective measures should be given significant weight in assessing the risk DEC presents to equity investors as compared that presented by the companies in the proxy group. [Tr. Vol. 4, pp. 472–73, 474–75 ("So I agree with you that it can be an indirect measure of business risk, but certainly is not a full measure of business risk from the perspective of an equity investor."), 475–76, 477 ("I do not think you can also strongly correlate credit ratings with cost of equity estimates."), 480.] Mr. Hevert took this position even though he used credit ratings as a basis to ensure comparability of the proxy group by excluding companies that did not attain an investment grade senior unsecured bond or corporate credit rating from Standard & Poor's. (Tr. Vol. 4, pp. 111, 465.)

Critically, Mr. Hevert was unable to point to any objective measure indicating DEC is comparatively more risky than the companies in the proxy group. *See* Tr. Vol. 4, p. 478 ("So in terms of attributing basis points of the return to individual aspects of risk, I have not done that, nor do I think it's feasible to do it in any reliable fashion."). In addition, Mr. Hevert did not perform a comparative analysis of whether the risk factors identified in equity analyst reports concerning DEC were also noted in the corresponding reports for companies in the proxy group. (Tr. Vol. 4, pp. 483–84.) As a result, Mr. Hevert rested on his subjective judgment—not quantitative or comparative analysis—to arrive at his conclusion that DEC presents a higher risk profile warranting both departing upwards from the results of his empirical models and fixing upon an ROE at the high end of his range. *See id*. ("It's judgment, and it's judgment having to do with the effect of rising interest rates, rising volatility, and it also has to do with some of the risks faced by companies such as Duke Energy Carolinas. . . . This is simply a matter of judgment.").

In sum, Mr. Hevert is unable to ground his ROE recommendation either in familiar empirical models such as mean growth rate DCF models, which this Commission has accorded substantial weight in prior rate cases, or in a comparative analysis of DEC's risk profile based upon objective measures of risk. Instead, DEC's position that it is entitled to an ROE of 10.75% and that the DEC-Public Staff stipulated ROE of 9.9% is appropriate rests almost entirely on Mr. Hevert's "judgment" as to comparative risk and on his presentation of recently authorized ROEs in this and other jurisdictions.[16] This approach is insufficient to justify either ROE figure because it fails to show fidelity to the requirements of Hope and Bluefield. Those cases instruct that ROE "should be commensurate with returns on investments in other enterprises having corresponding risks." Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943). Neither Mr. Hevert's judgment, nor rates of return authorized in other jurisdictions, provide the Commission with an evidentiary record on which it can set DEC's ROE in accordance with the standard prescribed in Hope and Bluefield because they do not turn upon an assessment required DEC's return in comparison to utilities facing corresponding risk.

While it is true that the stipulated ROE is nearly midway between Mr. Hevert's original recommendation and the Public Staff's proposal, where one side's proposal—here, Mr. Hevert's—lacks any objective indicia of a rational basis, the mathematical convenience of the stipulated rate is insufficient justification, standing alone, for its adoption.

If an applicant, as DEC does here, advocates an ROE figure that substantially exceeds the output of widely recognized empirical models and that also exceeds recently authorized ROEs, the applicant must justify that proposed upward departure with a quantitative analysis that shows the applicant's risk profile to be materially higher than that of the proxy group. DEC has failed to do so here, and the ROE that Mr. Hevert recommends is therefore plainly without basis. Although the DEC-Public Staff stipulated ROE is closer to the results of Mr. Hevert's empirical models, it still exceeds the average DCF results by over 100 basis points and the average of all his empirical models by 29 basis points. (See Tech Hevert Ex. 2.) In the absence of evidence demonstrating that DEC presents a greater risk to equity investors than do the companies of the proxy group, even the smaller upward departure finds insufficient record support.

[16] Even then, Mr. Hevert cherry picks and reclassifies the data on recently authorized ROEs. The Tech Customers Hevert Cross Exhibit 2 illustrates than when outlier rate cases are removed, the average ROE for vertically integrated utilities is 9.65% for 2017 determinations and 9.72% for 2015–2017 determinations. Thus, Mr. Hevert's recommended ROE of 10.75% and the DEC-Public Staff stipulated ROE of 9.9% *still* represent upward departures from these reference points without any underlying empirical justification. *See* Tech Hevert Ex. 2.

In sum, the Commission determines the appropriate rate of return on equity based upon the evidence and particular circumstances of each case. Here, the widely recognized empirical models offered by DEC witness Hevert and the other expert witnesses yield results below the Stipulated ROE of 9.9%. [*See* Tr. Vol. 4, pp. 404, 457–58; Tech Hevert Ex. 1 (average of Hevert DCF models is 8.65% and average of all Hevert models is 9.61%); Tr. Vol. 26, pp. 806–808 (Public Staff witness Parnell recommended range of 8.7% to 9.5%); Tr. Vol. 11, p. 99 (NCAG witness Woolridge's recommended range of 7.9% to 8.4%).] The Commission also believes that the rate of return on equity trends and decisions by other regulatory authorities deserve some weight, as (1) they provide a check or additional perspective on the case-specific circumstances, and (2) the Company must compete with other regulated utilities in the capital markets, meaning that a rate of return on equity significantly lower than that approved for other utilities of comparable risk would undermine the Company's ability to raise necessary capital, while a rate of return on equity significantly higher than other utilities of comparable risk would result in customers paying more than necessary. The recently authorized rates of return on equity fell at 9.65% for 2017 determinations and 9.72% for 2015–2017 determinations. [Tech Hevert Ex. 2; *see also* Tr. Vol. 26, p. 273 (CIGFUR III witness Phillips testimony of national average ROE for electric utilities of 9.63%)].

Given that evidence, and given the results of the empirical models and the lack of objective evidence offered by DEC that DEC presents a higher risk profile than the peer group warranting an upward departure from these measures, the Commission concludes that the Stipulated ROE of 9.9% is unreasonably high. (Tr. Vol. 4, pp. 404, 457–58; Tech Hevert Exs. 1, 2; Tr. Vol. 26, pp. 273, 806–808; Tr. Vol. 11, p. 99.) Accordingly, the evidence presented concerning other authorized rates of return on equity, when put into proper context, lends substantial support to an authorized rate of return on equity of 9.70%.

IT IS, THEREFORE, ORDERED as follows:

<u>Grid Reliability and Resiliency Rider</u>

1. The Company's proposal to implement a GRR Rider is denied and the Company's alternative proposal to implement a regulatory asset to record Power/Forward costs is denied.

<u>Tax Reform</u>

2. The amounts collected from ratepayers to defray DEC's tax obligations should be calculated based on the federal income tax rate established by the FTCJA.

3. EDIT associated with DEC's federal income tax obligations should be returned to ratepayers in accordance with the normalization rules of the Internal Revenue Service ("IRS") or, as proposed by the Public Staff, over five years through a levelized rider.

4. DEC's proposal to offset the reduction in its revenue requirement resulting from the FTCJA with $200 million in accelerated depreciation expense is denied.

Lee Nuclear Station

5. The Commission acknowledges the Company's decision to cancel the Lee Nuclear project as explained in its August 25th filing in Docket E-7, Sub 819.

6. The Company should be permitted to recover its costs associated with development of the Lee Nuclear Project subject to the following adjustments.

- DEC should only be allowed to recover the North Carolina allocable share of its actual costs, including AFUDC, incurred in the period up to December 31, 2009, if those actual costs are less than the not-to-exceed limits in the 2007 Order and the 2008 Order. Based upon the evidence in the record, this is the North Carolina allocable share of $172,002,979, including AFUDC.

- DEC should only be allowed to recover costs of the Lee Nuclear project after January 1, 2011, to the extent those costs were clearly required to maintain the status quo and if those costs did not exceed the not-to-exceed cap of the North Carolina allocable share of $120 million, including AFUDC. Given DEC's failure to submit evidence which would allow the Commission to verify "status quo" expenditures, the Commission concludes that it is appropriate to deny recovery for costs incurred during this period as there is no basis for concluding that such costs were reasonably and prudently incurred.[17]

- DEC should not be permitted to recover AFUDC on its costs after August 5, 2011, the date of the Commission's last project development costs order in Docket No. E-7, Sub 819, when the Commission made clear that it was taking DEC at its word that it had no present intent to construct Lee.

[17] **[*ALTERNATIVE*]** The Commission concludes that it is appropriate to allow only the costs during this period most closely identified with maintenance of the "status quo," which is the North Carolina allocable share of $73,111,397 without AFUDC.

- DEC's costs incurred in 2010 were denied in the 2011 Order and, therefore, are not recoverable.

Return on Equity

7. The Company has failed to support with objective analysis either the ROE figure sought in its application or the return on equity to which it stipulated with the Public Staff.

8. The Stipulated ROE of 9.9% is unreasonably high. The evidence presented concerning other authorized rates of return on equity, when put into proper context, lends substantial support to an authorized rate of return on equity of 9.70%.

This ____ day of _______, 2018.

NORTH CAROLINA UTILITIES COMMISSION

Certificate of Service

I hereby certify that a copy of the foregoing *Partial Proposed Order Granting Rate Increase of the Tech Customers* has been served this day upon counsel for all parties of record in this proceeding by electronic mail.

This the 27th day of April 2018.

BROOKS, PIERCE, MCLENDON,
HUMPHREY & LEONARD, LLP