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

DOCKET NO. E-7, SUB 1146 In the Matter of Application by 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 Petition of Duke Energy Carolinas, LLC, for an Order Approving a Job Retention Rider	)	POST-HEARING BRIEF OF APPLE INC., FACEBOOK, INC., and GOOGLE LLC ("TECH CUSTOMERS")

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Intervenors Apple Inc., Facebook, Inc., and Google LLC (collectively, "Tech Customers"), by and through counsel, submit this Post-Hearing Brief in the above-captioned matters.

INTRODUCTION

This proceeding concerns the rates to be charged by Duke Energy Carolinas, LLC ("DEC"), for electricity service in the future and raises a number of significant policy concerns, including how the Commission should handle the effects of the federal Tax Cuts and Jobs Act, how DEC and its customers should pay for infrastructure investments to improve the electrical grid, and whether and how DEC shareholders and its customers should share the costs of DEC's decisions to pursue and then cancel the development of the William States Lee Nuclear Generating Station project. The Commission's decisions on these issues will have substantial effects on the rates charged by DEC, which will significantly impact DEC's customers, and, more broadly, the economy of the state.

Each of the Tech Customers is a provider of online services and products. In connection with these business operations, the Tech Customers, through their respective affiliates, own and operate data centers and related infrastructure in the service territory of DEC. Data centers are high load factor facilities that use energy on a 24-hours-a-day, seven-days-a-week basis. Each of the data centers owned and operated by the Tech Customers in DEC's service territory uses electricity sold by DEC and is affected by DEC's operation of its electric generation, transmission and distribution facilities. The availability of an adequate supply of electricity at a reasonable price is critically important to the viability of the Tech Customers' data center operations.

SUMMARY OF ARGUMENT

This brief addresses legal and factual issues related to (1) DEC's request for a Grid Reliability and Resiliency Rider ("GRR Rider"); (2) implementation of the Tax Cuts and Jobs Act; (3) DEC's recovery of spending related to the William States Lee Nuclear Generating Station Project ("Lee Nuclear project"); and (4) DEC's allowed return on equity. Tech Customers urge the Commission to deny a number of DEC's requests related to these issues in order to establish just and reasonable rates.

The Commission should deny DEC's request for a GRR Rider to help DEC pay for its proposed Power/Forward initiative. The evidence shows that DEC's Power/Forward plan is part of a corporate strategy of DEC's holding company designed to use grid investment to drive shareholder earnings. Review of the Commission's ratemaking authority and past cases approving or denying rider requests make clear that DEC's proposed rider is beyond the Commission's authority to grant for a number of reasons. First, the proposed rider would create a single-issue ratemaking procedure outside of general rate case proceedings. Second, it would authorize recovery of planned infrastructure expenditures before any utility property was made "used and useful" to ratepayers. Third, there is no specific statutory authorization for the proposed rider. And fourth, unlike previous cases, there are no extraordinary circumstances such as wildly fluctuating fuel prices justifying the rider; on the contrary, DEC has complete discretion over the timing and amount of spending.

Even if the Commission could authorize the GRR Rider, DEC has failed to provide competent evidence supporting the rider. Through Power/Forward and the GRR Rider, DEC transparently seeks to accelerate T&D infrastructure spending for the benefit of shareholders, not ratepayers. DEC's holding company has explicitly stated its plan to drive earnings through T&D infrastructure spending. Critically, DEC admits that it would make most or all these planned investments—which ostensibly it must make to fulfill its duty to provide reliable electricity service—even if the rider is not approved, although perhaps over a longer period of time. DEC's stated goals are to accelerate spending and to reduce regulatory lag—benefits that would accrue only to shareholders.

Furthermore, DEC failed to show that there is an immediate need for any of its Power/Forward projects. In fact, DEC failed to produce evidence even identifying specific projects it intends to pursue in the next year or any time beyond that. Furthermore, many of the broad categories of spending identified by DEC as part of the Power/Foward initiative, such as undergrounding, are indistinguishable from customary T&D spending. Moving these amorphous categories of spending out of general rate case review as DEC proposes improperly shifts risk of recovery from DEC to ratepayers and threatens to unbalance the ratemaking process by creating a single-issue rate adjustment for what is intended to be a massive increase in DEC's rate base. Declining service reliability metrics cited by DEC do not show that Power/Forward or the GRR Rider are necessary or the best solution for ratepayers. The economic impact study of the Power/Forward initiative submitted by DEC does not support creation of a rider.

The Commission should pass the benefits of the Tax Cuts and Jobs Act to ratepayers by reducing DEC's rates and returning excess deferred income taxes to ratepayers over a reasonable period. Tech Customers support the Public Staff's proposal to reduce DEC's rates to reflect the reduced corporate tax rate and to have DEC return deferred income taxes to ratepayers over five years. The Commission should reject DEC's proposal to nullify the benefits of tax reform by offsetting DEC's decreased revenue requirements and to stretch return of deferred income taxes over a twenty-year period.

The Commission should limit DEC's recovery of costs related to the canceled Lee Nuclear project.

DEC's request that the Commission "approve" its internal business decision to cancel the project should be rejected, as the Commission has no authority to approve (or disapprove) the cancelation of a hypothetical project.

As to recovery of costs, the Commission should limit DEC's recovery in several ways. First, the Commission should not second-guess its 2011 Order regarding Lee Nuclear costs and should reject DEC's request for recovery of post-2011 costs not approved in that order when the facts available at the time DEC made its decision showed incurring those costs would not be reasonable and prudent. In the 2011 Order, the Commission found that spending on Lee Nuclear after January 1, 2011 would be reasonable and prudent only to the extent it was (1) necessary to maintain the status quo and (2) less than or equal to the North Carolina allocable share of $120 million. The 2011 Order necessarily implied that spending for other purposes or that exceeded the approved amount would not be reasonable and prudent. DEC has presented no evidence that the 2011 Order was wrong; rather, subsequent events confirm that the concerns the Commission found weighed against additional spending were correct. DEC should not be allowed to recover costs (1) not shown by DEC to be necessary to maintain the status quo or (2) in excess the North Carolina allocable share of $120 million when it was warned in advance incurring those costs would not be reasonable and prudent. DEC's decision to disregard the limitations of the Commission's order was taken at its shareholders' risk, not ratepayers'.

Second, the Commission should deny DEC's request for a return on unamortized Lee Nuclear costs. The Commission's past practice has been to equitably share canceled plant costs between ratepayers and shareholders by denying a return on unamortized costs, and there is no reason to deviate from that practice here.

Third, the Commission should reduce DEC's recovery of other costs, including post-2011 AFUDC. The facts here show that since at least 2011 DEC has not actually had an intent to construct the Lee Nuclear project. AFUDC should be not be allowed during this period, when (as shown by DEC's 2011 testimony and subsequent internal communications) DEC was not actually pursuing the Lee Nuclear project, but only an "option" to do so at some undetermined, later date.

Finally, the Commission should reduce the return on equity requested by DEC to set just and reasonable rates. DEC has failed to justify its requested return on equity, including the reduced rate of 9.9% recommended in the Stipulation between DEC and Public Staff. DEC relies entirely on the subjective judgment of its witness Hevert, but data and empirical analysis show that the return sought by DEC is not reflective of its risk relative to comparable utilities.

I. The Commission Should Deny DEC's Request for a "Grid Reliability and Resiliency" Rider.

DEC asks the Commission to approve a "grid reliability and resiliency" rider ("GRR Rider") so that DEC may recover the costs of its proposed Power/Forward Carolinas initiative without filing a rate case. Power/Forward is a corporate-driven initiative announced by Duke Energy Corporation in spring of 2017 as a means of accelerating the transmission and distribution ("T&D") investments of its affiliates. The total amount DEC proposes to recover under the Power/Forward initiative over ten years is approximately $13 billion, which exceeds the value of the rate base DEC proposes in this case. Tr. Vol. 26, p. 463.[1] Approval of the GRR Rider would essentially allow DEC to double its rate base without filing a general rate case. *Id.* at 471-72. DEC's proposal should be rejected for two reasons. First, it is beyond the authority of this Commission to allow recovery of utility infrastructure investments from ratepayers in the manner proposed. Second, even if the Commission has such authority, the proposed rider is an inappropriate regulatory mechanism to accomplish DEC's goals.

A. The Commission lacks authority to impose the GRR Rider.

As a threshold matter, DEC's request is simply beyond the Commission's authority to grant. DEC's proposal to create a mechanism that could potentially double its rate base over a ten-year period outside the normal ratemaking process subverts the ratemaking scheme established by the General Assembly that operates to ensure fairness both to the utility and its ratepayers.

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.

[1] DEC proposes to use an annual rider to collect projected revenue requirements and a true-up for prior periods to collect the incremental costs of its Power/Forward investments, including depreciation costs, financing costs, and incremental operating expenses, including a return on investment, but not accounting for any cost savings or other efficiencies that might otherwise result in downward adjustments to rates. Amounts not recovered via the rider would be incorporated into base rates in DEC's next general rate case. Tr. Vol. 6, pp. 271-73.

Order Denying Request to Implement Rate Rider and Scheduling Hearing to Consider Request for Creation of Regulatory Asset Account, Docket No. E-7, Sub 849, at 18 n.2 (June 2, 2008) ("*In re DEC Drought Rider*"). DEC's proposed GRR Rider comports with none of these procedures. DEC has not sought a rulemaking proceeding; DEC has not shown (or even suggested) that its income will be insufficient or otherwise necessitate a G.S. § 62-136(a) complaint proceeding; and there is no specific statute authorizing 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.

That the GRR Rider is proposed in connection with a general rate case, however, does not mean the mechanism proposed complies with G.S. § 62-133. Certainly a rider may be used by the Commission in a rate case as a convenient tool to effectuate the establishment of just and reasonable rates; but it may not be used as a tool of evading the statutory requirements for setting rates—which is what DEC proposes here.

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 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. The provisions of G.S. § 62-133 would not apply to the annual adjustments contemplated by DEC's proposal. 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. Tr. Vol. 6, p. 270.

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.

Under the statutory ratemaking procedure, 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. *See State ex rel. Utilities Commission v. Morgan,* 277 N.C. 255, 273, 177 S.E.2d 405, 417 (1970), *aff'd*, 278 N.C. 235 (1971) (holding that, under G.S. § 62-133(c) then applicable, it was error to include CWIP in rate base because those costs were not specifically allowed by statute).

There is simply 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.[2]

[2] For similar reasons, DEC's alternative request for establishment of a regulatory asset for future recovery in a rate case should be denied. (Tr. Vol. 6, pl. 37.) DEC's request to segregate out Power/Forward costs, including a carrying charge on the deferred balance, is (1) unnecessary, as DEC has not shown that the proposed investments are sufficiently distinguished from customary spend, unsupported by the evidence concerning proposed DEC's Power/Forward investments, (2) inappropriate, given that DEC's proposal lacks protections to ensure that the Commission's normal rate processes are respected, and (3) contrary to the law, in that the creation of a regulatory account, under these circumstances, is another version of prohibited single-issue ratemaking.

DEC suggests that the Commission can approve its GRR Rider request because it has been made in conjunction with a general rate case, *see* Application at 6 n.2, as if a rate case somehow operates outside the General Statutes. DEC primarily relies on the North Carolina Supreme Court's decision in *State ex rel. Utils. Comm'n v. Edmisten*, 291 N.C. 327, 230 S.E.2d 651 (1976) ("*Edmisten I*"). 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). Each of the cases is easily distinguished.

In *Edmisten I,* the North Carolina Supreme Court affirmed the Commission's approval of a fuel adjustment rider in connection with a general rate proceeding in the mid-1970s. The Court recognized that the fuel rider problematically "isolate[d] for special treatment only one element of the utility's cost" but nonetheless approved the additive since it was adopted consistent with general ratemaking principles, not as a means to avoid those principles. *See id.*, 291 N.C. at 340–41, 230 S.E.2d at 659. The court recognized these key factors: (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 fuel rider 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 to achieve those rates despite the energy crisis impacting the utility's costs. Crucially, the Supreme Court recognized 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. First, the fuel adjustment rider addressed necessary and unavoidable costs, 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. Second, DEC has not shown any exigent circumstances causing its operating costs to wildly fluctuate. Third, where the fuel adjustment rider was necessary to allow the utility to recover its costs and earn its authorized return, DEC has presented no evidence, and does not even assert, that its proposed rider is necessary for it to recover costs or to earn its authorized return. *Edmisten I* is not an endorsement of an end-run around the statutory rate-setting mechanisms; to the contrary, central to the Court's holding was the Commission's conclusion that the rider was critical to the achievement of the statutorily prescribed rates.

Similarly, the Commission's approval of coal inventory riders in connection with DEC's 2009 and 2013 rate cases,[3] provides 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

[3] S*ee* 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).

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 other words, consistent with the Commission's normal ratemaking authority, the riders were approved as convenient mechanisms for recovering operating costs that had already been incurred (or committed under contracts) by the utility and reviewed by the Commission. In contrast, DEC seeks approval here 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 are in no way analogous to the GRR Rider. Both riders were created pursuant to specific statutory authority: JAAR under G.S. § 62-133.14 and the BPM rider under G.S. § 62-133.6(e)(2). *See* Order Approving Joint Agency Asset Rider Adjustment, Docket No. E-2, Sub 1110 (Nov. 7, 2016); *see, e.g.*, Docket No. E-7, Sub 751; Docket No. E-7, Sub 1026, at 13 (2017). Neither statute applies to DEC's proposal.

Most similar to DEC's proposal in this case—but not cited in its Application—are infrastructure improvement and replacement recovery riders for natural gas utilities and water and sewer utilities under G.S. §§ 62-133.7A and 62-133.12. The fact that express statutory authority was necessary prior to the implementation of these riders underscores the lack of authority to implement the GRR Rider. None of the limited provisions in G.S. §§ 62-133.1-.15 apply to the GRR Rider. The General Assembly's creation of statutory authority for rate adjustment mechanisms for other purposes makes clear that the Commission lacks authority to approve DEC's proposed rider.

Post *Edmisten I*, the Commission has recognized that its authority to implement riders must be tethered to its underlying governing statutes, whether the rider is sought in or outside of a general rate case.

For example, in rejecting DEC's request for implementation of a rider 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.

Even in the context of general rate cases, the Commission has 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." *In re Pub. Serv. Co. of N.C.*, Docket No. G-5, Sub 356, at 10-13 (Sept. 25, 1996) ("*PSNC*"). In *PSNC*, 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. 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" but rather were "generally controllable" by the utility. *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.* Third, 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 rider was also problematic because it "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 as part of a general rate case. 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 a 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 (*see id.*, at 19) and that there was insufficient justification for treating purchased power expenses any differently from other expense items in the ratemaking process, stating as follows:

> The Company's proposed NUG rider mechanism would preclude appropriate regulatory oversight of the Company's overall expenses. This is because increases in payments to NUGs for additional capacity and energy could be offset by decreases in other cost of service items, such as reduced operation and maintenance expenses, and increases in sales and revenues (particularly since use of non-utility generation will likely result in some decreased use of Company-owned generation and therefore decreased expenses, and will likely result in increased revenue from additional sales for which the Company otherwise has negligible expenses). Review of the Company's total cost of service in the context of a general rate case is the most effective way to balance these elements.

Id., at p. 19-20. Based on these "policy and legal concerns," the Commission denied NC Power's request.[4]

The GRR Rider is analogous to the riders addressed in *PSNC* and *In re VEPCO*, and should be 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

[4] 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.

savings it realizes as a result of its proposed massive $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 must be denied.

B. Setting aside its legal infirmity, DEC's proposed rider suffers from numerous structural and evidentiary flaws that render it an inappropriate regulatory mechanism.

Even if the Commission had authority to grant DEC's request, DEC's proposal suffers from numerous flaws that make it a distinctly inappropriate regulatory mechanism for approval by the Commission.

i. DEC has not justified the use of an extraordinary rider mechanism for its proposed Power/Forward Carolinas investments.

The regulatory framework typically employs riders for costs that are beyond the control of the utility such as fuel and purchased power. Although riders have been approved in some instances for capital investments where they are authorized by statute, DEC has not provided sufficient justification to treat grid modernization investments any differently from the other infrastructure investments that comprise DEC's rate base.

As DEC's North Carolina President, Mr. Fountain, conceded, DEC does not claim it will not make the proposed T&D investments without the GRR Rider. *E.g.*, Tr. Vol. 6, p. 431-32. 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. And it is clear that the GRR Rider would have a number of beneficial effects on DEC's earnings, including that it would ensure more rapid recovery of earnings from its T&D investments and potentially 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 task 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).

ii. DEC has not adequately differentiated between the ongoing investments it plans to make in its T&D systems and the modernization investments it includes in its proposed Power/Forward Carolinas program.

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 do not describe specific planned expenditures. Instead, DEC resorts to broad, amorphous descriptions of categories of potential projects 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 short, DEC has not shown that the proposed investments are necessary, reasonable, and prudent; instead, DEC appears to be requesting that the Commission authorize the issuance of a "blank check" to be paid for by ratepayers.

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; as demonstrated by the table set forth in the testimony of Tech Company witness Strunk,[5] which is attached to this filing as Exhibit A, DEC's descriptions of its proposed rider investments are indistinguishable from conventional T&D investments. *See* 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 customary T&D investments. Tr. Vol. 26, p. 479. Moreover, this lack of distinction 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

[5] *See* Testimony of Kurt Strunk, Tr. Vol. 26, at pp. 477-78, at Table 3: Customary Network Investments *vs.* Power/Forward Carolinas.

demonstrates the unsuitability of the mechanism proposed by DEC to further its plans for earnings growth.

iii. DEC's proposed use of a rider for such a large component of ongoing capital investment threatens to unbalance the regulatory process.

DEC's proposed rider would unbalance the ratemaking process. By avoiding periodic reviews of DEC's aggregate cost of service in a general rate case, a rider would cause a significant disconnect between rates and DEC's cost of service.

The sheer magnitude of DEC's proposed Power/Forward program should defeat DEC's request to raise rates outside the formal ratemaking process. As discussed by witness Strunk, because the Power/Forward program calls for investments exceeding the amount of DEC's current rate base, it threatens to subvert the general rate case process by removing cost recovery of vast amounts of T&D spending from the general rate case procedure required by G.S. § 62-133. Tr. Vol. 26, pp. 480-81. This is particularly concerning because, as DEC witnesses Simpson admits, the GRR Rider will function as a one-way ratchet to increase rates without recognizing cost savings. *See* Tr. Vol. 16, p. 120; Tr. Vol. 23, p. 171; *see also* Tr. Vol. 6, pp. 401, 439 (cross-examination of DEC witness McManeus). This is precisely the kind of result that general rate cases, by avoiding single-issue ratemaking, are intended to avoid. To this point, the proposed rider "has the effect of transferring any perceived risks[] of cost recovery of DEC's expenditures on its transmission and distribution systems[] from its shareholders to its customers," *See* Testimony of Public Staff Witness Parcell, Tr. Vol. 26, p. 829. *See also* Tr. Vol. 14, pp. 57-58 (NCSEA witness Golin); Tr. Vol. 26, p. 277 (CIGFUR III witness Phillips); Tr. Vol. 26, p. 535 (Commercial Group witnesses Chriss and Rosa).

Although DEC contends that other states have implemented similar tracker mechanisms, DEC's proposed Power/Forward program and GRR Rider are far more costly than programs implemented in other jurisdictions. *See* Strunk Testimony, Tr. Vol. 26, p. 472. In addition, initiatives pursued in those other jurisdictions were "part of efforts to comply with statutory or regulatory compliance mandates or to advance economic development efforts." *Id.* at 473. In contrast, the DEC program is for investment that is indistinguishable from customary spend and is intended to drive Duke Energy's corporate earnings, not the economy of the state. In short, the use of infrastructure trackers in other jurisdictions does not support the use of DEC's proposed rider.

iv. DEC's analysis purporting to justify the expenditures to be recovered by the GRR Rider is flawed in several respects.

DEC attempts to justify the GRR Rider with two basic assertions: (1) declining service quality metrics show a significant decline in system service quality that must be addressed through a substantial investment program, and (2) the investment is justified by the indirect positive economic impact it will generate. Neither of these assertions is valid and neither justify the proposed GRR Rider.

DEC points to recent service quality metrics as measured by SAIFI and SAIDI. *E.g.*, Tr. Vol. 16, pp. 98-100. However, while DEC notes a worsening trend, those metrics are subject to considerable variation and remain within the range in which they have been for the last 15 years and are actually below the range cited in DEC's last rate case. *See* Simpson Tech Customers Cross-Examination Exhibit 2; Tr. Vol. 16 pp. 176-83. 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. Moreover, although DEC's statistical analysis suggests weather-related outages are on the rise, DEC witness Simpson testified that the top three reasons for outages are "vegetation, equipment failure, and public accidents." Tr. Vol. 17, p. 111. He testified that outages resulting from vegetation are particularly concerning because vegetation is the "number one" cause of outages in the test year and there is a backlog of vegetation work. Tr. Vol. 22, pp. 238-39. Finally, there is insufficient evidence of a direct link between the specific investments proposed and the specific problem DEC identifies as needing to be solved.

In addition, DEC attempts to justify its Power/Forward program by pointing to the positive economic effects of the program. However, DEC's testimony and analyses regarding program benefits are flawed. In particular, the economic report prepared by Ernst & Young (the "EY analysis") (1) improperly focuses on indirect, rather than direct, economic benefits of the program; (2) excludes analysis of program risks; and (3) assumes there are "deteriorating reliability trends" that are unproven. *See* Strunk Testimony, Tr. Vol. 26, pp. 486-95. The study also suggests that the Power/Forward program is desirable because it appears it would have a positive economic impact, but it ignores the fact that practically any sizeable investment will have a positive economic impact. Tr. Vol. 17, pp. 40-41. The Commission should not rely on DEC's flawed analysis as justification for the GRR Rider when DEC has failed to show that the program is the best investment for DEC's customers. It is not the Commission's job to attempt to stimulate the economy through the secondary effects of increased utility investment. Such a goal contradicts the

Commission's responsibility to ensure that rates are "as low as possible." *See* Order Granting Partial Rate Increase, Docket No. E-2, Sub 1142, at p. 59 (Feb. 23, 2018).

II. The Commission Should Pass the Benefits of Federal Tax Reform Directly to DEC's Customers by Lowering Rates to Reflect the Reduced Rate and Returning Tax Over-Collections Over a Reasonable Period.

The Tax Cuts and Jobs Act ("2017 Tax Act") reduced the corporate tax rate applicable to DEC from 35% to 21%, effective January 1, 2018. Pub. L. 115-97, Title I, § 13001(a), Dec. 22, 2017, 131 Stat. 2096. The Commission has dealt with similar issues in two prior generic proceedings,[6] and, similarly, has established a new generic docket to consider implementation of the 2017 Tax Act. *See* Docket No. M-100, Sub 148. However, it appears that all parties are in agreement that, as to DEC, the Commission should consider and implement the effects of federal tax reform in this proceeding, as opposed to the generic proceeding generally applicable to utilities. *See* Tr. Vol. 5, p. 14[7]; Tr. Vol. 5, pp. 65-86 (DEC redirect of witness De May; introduction of DEC tax proposal).

DEC proposes that the Commission should implement changes resulting from the 2017 Tax Act by (1) incorporating a $211 million reduction in revenue requirements to reflect the corporate tax decrease; (2) incorporating reductions totaling $96 million to return excess deferred income taxes ("EDIT") to customers, including (a) returning

[6] In Docket No. M-100, Sub 113, the Commission addressed tax reductions from the Federal Tax Reform Act of 1986 (TRA86). Among other things, TRA86 reduced the top corporate tax rate from 46% to 34%. In Docket No. M-100, Sub 148, the Commission addressed the tax reductions from the State House Bill 998 (S.L. 2013-316), which, among other things, changed the net income tax imposed on C Corporations and amended the gross receipts and franchise taxes.

[7] Colloquy between Chairman Finley and DEC counsel: Question: "… When Duke filed this case it was back in August, and nobody was able to anticipate what Congress was going to do with respect to this tax reduction. So the question before the house right now is does Duke wish to recognize the changes in the tax law that went into effect January 1, 2018 for purposes of establishing rates in this case or not?" Response: "Yes, Mr. Chairman. We do. …")

protected EDIT according to IRS rules, (b) returning unprotected EDIT related to property, plant, and equipment ("PP&E") over 20 years, and (c) returning other unprotected EDIT over five years; and (3) incorporating an increase in revenue requirements of $200 million to collect certain expenses, such as AMR meter or coal-fired plant depreciation and coal ash basin closure compliance costs, on an accelerated basis. *See* DeMay Rebuttal Ex. 5, Supp. Comments of Duke Energy, Docket No. M-100, Sub 148, at 2-6 (March 1, 2018). The Public Staff has proposed returning protected EDIT as prescribed by the IRS, returning all unprotected EDIT to ratepayers via a five-year rider, and otherwise immediately flowing through all benefits of the 2017 Tax Act to ratepayers without any revenue requirement increase to offset the resulting lower rates. Tr. Vol. 26, pp. 635-39.

A. The going-forward rates approved in this proceeding should reflect DEC's federal tax obligations as modified by the 2017 Tax Act.

DEC proposes[8] to reduce the annual revenue requirement sought in its original rate case filings by $211 million to reflect the fact that DEC's federal income tax obligation has been decreased from 35% to 21%. The Public Staff has reviewed and is in accord with this reduction. Tr. Vol. 26, p. 634; Boswell Third Supplemental and Stipulation Ex. 1, at Schedule 1, p. 2. The Tech Customers agree that these direct benefits from the 2017 Tax Act should be passed directly to ratepayers. As the Commission recognized the last time the corporate tax rate was significantly reduced, "[i]t is incumbent upon this Commission to take the appropriate action as required so as to preserve and flow through to ratepayers,

[8] DEC's initial proposed revenue requirement—as established in its application for rate increase and its pre-filed testimony—was submitted based upon the federal income tax rate in effect prior to the enactment of the 2017 Tax Act. At the hearing in this matter, DEC notified the Commission of its intention to implement the 2017 Tax Act as part of its general rate case, rather than in the generic tax proceeding. *See* Tr. Vol. 5, p. 14. Subsequently, DEC has submitted various exhibits stating its position regarding the implementation of federal tax reform.

as a reduction to public utility rates, any and all cost savings realized [] which would otherwise accrue solely to the benefit of the companies' stockholders." *Re Tax Reform Act of 1986*, Docket No. M-100, Sub 113, 82 P.U.R.4th 234, 234–35 (Oct. 23, 1986).

The Tech Customers do not believe that this reduction is optional. Given that DEC is in the midst of a general rate proceeding, the effect of the 2017 Tax Act on DEC's operating expenses must be accounted for by the Commission in fixing DEC's rates in this proceeding. *See, e.g.*, N.C. Gen. Stat. § 62-133(b)(3) and (c) (requiring rates to be based upon the "public utility's reasonable operating expenses" taking into account "evidence . . . tending to show actual changes in costs"). The uncontroverted evidence here shows that DEC's actual tax expense has been reduced effective January 1, 2018. The Commission cannot lawfully establish rates on a going-forward basis without accounting for the actual, currently effective tax rates. To set rates for utility ratepayers based on a tax rate no longer in effect would be contrary to the statutory requirements for setting rates and would unfairly and improperly collect from ratepayers amounts that are not due.

B. The Commission should return all of DEC's EDIT in the manner proposed by the Public Staff.

In its proposal regarding the return of EDIT[9] to ratepayers, DEC differentiates between "protected" EDIT, which is subject to IRS normalization rules, and "unprotected" EDIT, which is not.

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[9] EDIT results from the fact that in the early years of a given capital asset, the utility collects more in tax expense from ratepayers than it pays out to the Internal Revenue Service due to the difference in accelerated depreciation for tax purposes and straight-line depreciation for ratemaking purposes. This interest-free loan is reflected as a credit to the utility's accumulated deferred income taxes ("ADIT") liability account. Due to the 2017 Tax Act, DEC's future tax liabilities will be lower than originally anticipated. The amount by which DEC's current ADIT balances exceeds its future income tax liability as a result of the 2017 Tax Act are the excess deferred income taxes ("EDIT") at issue.

Regarding "protected" EDIT, the parties appear to agree that the IRS normalization rules apply and should be followed. IRS normalization rules generally require protected EDIT to be returned over the remaining useful life of the asset from which it derives. The Tech Customers are in accord with this approach.

Regarding unprotected EDIT, DEC proposes to divide this category into "unprotected PP&E" and "unprotected other" and proposes to return EDIT to ratepayers over periods of 20 years and five years, respectively. This proposal has the effect of greatly delaying the return of the overcollections to ratepayers since "unprotected PP&E" represents approximately 82% of the amounts in issue. *See* Second Supplemental Testimony of Public Staff Witness Boswell, at 6. By contrast, the Public Staff proposes to return all "unprotected" EDIT via a five-year levelized rider.[10]

The Tech Customers agree with the recommendation of the Public Staff, as this is the approach that best balances the need to expeditiously return overcollections to ratepayers and DEC's interest in managing its cash flow.

DEC concedes that the Commission has discretion over how so-called "unprotected" EDIT is returned to ratepayers because those deferred taxes are not subject to IRS normalization rules. Tr. Vol. 8, p. 224. This concession is necessary because the PP&E assets for which DEC seeks a 20-year amortization period—like other unprotected EDIT—are not subject to IRS normalization rules. DEC's effort to divide these assets into "PP&E" and "non-PPE" categories are not supported by any logical accounting or ratemaking principle. *See* Second Supplemental Testimony of Public Staff Witness

[10] Under this proposal, the reduced ADIT that are deducted from rate base will be reflected in rate base adjustments rather than the rider. *See* Duke Energy Supplemental Comments, Docket No. M-100, Sub 148 (March 1, 2018), at 4.

Boswell, at 8. Instead they are arbitrarily manufactured categories intended to achieve a certain result. DEC contends that the PP&E assets with unprotected EDIT "feel like the protected kind," and that they should therefore be returned over a period approximating the remaining useful life of the assets. Tr. Vol. 5, pp. 77-78. *See also* Duke Energy Supplemental Comments, Docket No. M-100, Sub 148 (March 1, 2018), at 4 ("This period aligns with the timeframe that the benefits (i.e., deferred tax liability offset to rate base) would be received by customers absent the change in tax rate."). However, Congress intentionally excluded EDIT from unprotected assets from the treatment given to protected EDIT because the excluded assets do not have normal useful lives.[11] The depreciation rates and "lives" referred to by DEC merely reflect the accounting treatment DEC has given these accounts, not the useful life of actual PP&E, and there is simply no logical connection between this class of assets and DEC's proposal.

Twenty years is simply too long a period over which to return over-collected ratepayers' money, and DEC has offered no evidence suggesting otherwise. The longer the period, the longer the forced loan from ratepayers, which, as the Federal Energy Regulatory Commission has recognized may be a "necessary evil . . . [b]ut . . . nonetheless an evil" to be mitigated wherever possible. *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

[11] For example, DEC cites the following among its "PPE Other" assets: "AFUDC Debt," "Casualty Loss," "Clearing Cost," "Coal Ash – Capital for tax," "Depreciation Lag," "Hardware Capitalized," "Mixed Service Costs 263A," "ORIG TAX ADJ FED," "Other Adj," "Pension Cost," "Percentage Repair Allowance," "Salvage Artificial Loss," "Salvaged Inventory Proceeds," "SOFTWARE EXPENSED," "TAX EXPENSING," and "WESTINGHOUSE CREDIT." *See* DEC response to NC Public Staff Data Request No. 155-3, Docket No. E-7, Sub 1146 (filed March 22, 2018).

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."). Returning all unprotected EDIT over five years is a reasonable approach that appropriately balances the need to return the overcollections to ratepayers and the need to protect both DEC and ratepayers from the shocks that otherwise would result from significant rate decreases followed by rate hikes. Tr. Vol. 26, pp. 637-38. In this regard, the proposal is a net proposal which incorporates both the decrease in operating expenses related to the tax change and the increase in rate base associated with the lesser amount of ADIT that are deducted from the rate base, Tr. Vol. 26, p. 636; in other words, even in the absence of a future rate case, the proposal smooths out the potential negative impact on cash flow by netting out the additional revenues otherwise accruing from the increase in the rate base. In any event, DEC has failed to show that returning unprotected PP&E EDIT over five years would have any material adverse effect on DEC's cash flow or standing in the credit community. Accordingly, the recommendation of the Public Staff should be adopted.

C. The Commission should deny DEC's request to nullify the effects of tax reform by offsetting the reduced revenue requirement with $200 million per year in new spending.

DEC's invitation that the Commission offset nearly all of the $216 million revenue reduction resulting from the implementation of federal tax reform with a corresponding revenue increase of $200 million is contrary to Commission policy, unreasonable, and unsupported by evidence of any need to protect DEC's core financial position. DEC's request that the Commission issue it a "blank check" to defray federal tax reform is simply not a mechanism in the Commission's regulatory "tool box."

In support of DEC's request for an offsetting revenue increase, DEC witness DeMay explained that a revenue reduction to reflect tax reform would result in reduced cash flow to DEC, which could in turn damage DEC's credit standing by impairing DEC's funds from operation to debt ("FFO/debt") ratio. Tr. Vol. 4, pp. 434-36; *id.* p. 424; *see also* Tr. Vol. 8 pp. 226-227 (DEC witness McManeus testifying that the $200 million revenue increase "is intended to . . . take into consideration the cash flow needs of the Company, the impact on credit metrics, and the Company's financial health"). DeMay further testified that DEC's credit rating according to Moody's is subject to an FFO/debt "floor" of 25 percent, and that the Public Staff's proposal[12] would, at least temporarily, reduce DEC's FFO/debt ratio below 25 percent. Tr. Vol. 4, p. 436. DeMay referred to a recent assessment of DEC by Moody's and suggested that DEC could face a credit rating downgrade if "the FFO/Debt ratio fell below 25% on a sustained basis." Tr. Vol. 4, p. 84; *see* Moody's Investors Service, Credit Opinion dated October 6, 2017, Duke Energy Carolinas, LLC (DEC DeMay Rebuttal Exhibit 7), at 2 (noting as a factor that could lead to a downgrade "[a] decline in cash flow metrics, for example, if the ratio of CFO pre-W/C to debt fell below 25% on a sustained basis").

DEC has failed to show that ratepayers risk any negative impact resulting from reduced cash flow to DEC. DEC speculates that its FFO/Debt ratio may be impaired, but

[12] At the time of DeMay's testimony, the Public Staff proposed a two-year rider to return EDIT to ratepayers, rather than the five-year rider later proposed by Public Staff witness Boswell. As Boswell explained, the change from two years to five mitigates the cash flow constraint identified by DeMay. Tr. Vol. 26, p. 638.

has not shown that its FFO/debt ratio will be affected sufficiently to change its credit rating or to degrade its credit metrics. Indeed, DEC's own analysis of the Public Staff's proposal—including return of EDIT over two years rather than five—shows only a temporary reduction below 25 percent. The Moody's report on which DEC bases its request notes only that a "sustained" decrease of FFO/debt to below 25 percent is of concern. The Public Staff changed its proposed two-year EDIT flow-through rider to a five-year rider in part to mitigate even this limited concern.

Tech Customers witnesses Strunk and Brown-Hruska examined DEC's FFO/debt metric and found that DEC's projections show that its FFO/debt ratio would remain in the 24 to 26 percent range even if the requested $200 million revenue increase is denied. Tr. Vol. 26, p. 514. This range of FFO/debt is consistent with the assumptions of Standard & Poor's in evaluating DEC's creditworthiness prior to implementation of the 2017 Tax Act, *id.*, and is inconsistent with the sort of "sustained" decrease necessary to risk a downgrade or other similar credit action by Moody's. *Id.* at p. 517. To the contrary, by all objective measures, DEC's FFO/debt ratio and credit rating are among the highest among comparable utilities. *See id.* pp. 517-19. Although DEC witness De May raised qualitative concerns regarding the cash flow impacts of the 2017 Tax Act on DEC's credit standing, *e.g.*, Tr. Vol. 4, pp. 60-62, there are no objective data or criteria showing that passing the benefits of tax reform to ratepayers will negatively affect DEC's creditworthiness. As a result, there is no reasonable basis in the record for concluding that denial of the requested revenue increase would negatively impact DEC's credit standing or its ability to attract capital.

In sum, the requested offsetting revenue increase is unnecessary to ensure DEC maintains a healthy credit standing, and the request should be rejected so that ratepayers can receive the benefits of tax reform.

III. The Commission Should Limit DEC's Recovery of Costs Related to the Canceled Lee Nuclear project.

In somewhat of a *déjà vu* experience,[13] DEC 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 state allocable share of approximately $542 million, amortized over 12 years, including a return on the unamortized balance. The Public Staff argues that DEC should be allowed to amortize its actual costs,[14] with no return allowed on the unamortized portion. The Tech Customers support the Public Staff's position on disallowing 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 DEC 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.

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[13] Duke previously attempted to construct a nuclear facility at the exact same location as the Lee Nuclear project. *See* Kee Testimony, Exhibit EDK-2 and Tr. Vol. 11, p. 42. This project, too, was abandoned, and this Commission allowed Duke to recover some $700 million in project development costs from ratepayers. *See* Tr. Vol. 11, p. 42. With DEC's request here, Duke will have spent over $1 billion at this single location without producing any assets which are used and useful for ratepayers.

[14] The Public Staff has proposed an adjustment to DEC's claimed cost—the costs associated with a planned visitor center. DEC has accepted this adjustment.

A. The Commission is not required to "approve" DEC's decision to cancel the Lee Nuclear project.

DEC 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. *See* Fallon Direct Testimony at 24, Tr. Vol. 10, at 198; Tr. Vol. 11 at 69, lines 9-13. *See also* DEC Response to Tech Customers Data Request 4-7, attached hereto as Exhibit B. This statute, however, is not applicable to the present circumstances; even if the Commission interprets it otherwise, it does not—by its express terms—*require* Commission approval of DEC's decision to terminate.

The context of DEC's request is critical. 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) ("CPCN"); 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* N.C. Gen. Stat. § 62-110.1(e) (requiring Commission approval to cancel construction of a generating unit after issuance of a CPCN) *with* N.C. Gen. Stat. § 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 reason DEC is seeking the Commission's endorsement of its internal business decision is transparent—so long as the Commission "approves" its decision to cancel the project, DEC will argue that the Commission is required, as a matter of law, to permit recovery of <u>all</u> its costs associated with the Lee Nuclear project under G.S. § 110.7(d).[15] 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's approval to construct it, and it does not need any commission's approval to cancel it.

Given that no Commission approval of DEC's decision is necessary, the Commission should be wary of granting DEC's request, lest it be drawn into a debate as to whether such permission triggers a corresponding duty on the part of the Commission to permit recovery of "all" costs incurred by DEC in connection with the abandoned project.

[15] As stated below, the Tech Customers do not believe G.S. § 62-110.7(d) applies here. Nonetheless, if the Commission determines otherwise, that provision's reference to recovery of all costs does not override the other provisions of G.S. § 62-110.7 nor does it override this Commission's prior orders under this statute constraining the type and extent of costs that are authorized to be incurred.

B. **The Commission's determination that DEC's decision to incur costs post-2010 in excess of $120 million and except as necessary to maintain the status quo would not be reasonable and prudent precludes a finding that expenditures exceeding these limitations are recoverable.**

DEC is seeking to recover some $333 million in costs incurred in connection with the Lee Nuclear project on or after January 1, 2011, seemingly ignoring the Commission's prior order limiting costs in this period to a not-to-exceed cap of the North Carolina allocable share of $120 million and confining approved costs to those necessary to maintain the "status quo."

Contrary to the implication of DEC's request, the Commission's orders in Docket No. E-7, Sub 819, regarding DEC's decision to incur costs related to the Lee Nuclear project constrain the Commission's authority to allow recovery of Lee Nuclear costs in this proceeding. In particular, the Commission's 2011 denial of DEC's application, its limitation of the approval of costs to those necessary to maintain the status quo, and its capping of any such costs incurred at the North Carolina allocable portion of $120 million on or after January 1, 2011, preclude a finding that costs exceeding those spending constraints are recoverable as reasonable and prudent expenditures.

G.S. § 62-110.7(b) provides, in pertinent part, as follows:

> At any time prior to the filing of an application for a certificate to construct a potential nuclear electric generating facility, . . . a public utility may request that the Commission review the public utility's decision to incur project development costs. . . . 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.

This provision thus allows, but does not require, a public utility to subject its decisions to incur nuclear project development costs to Commission review prior to incurring such costs.[16]

Approval of a decision to incur costs does not guarantee ultimate recovery of any "specific items of cost," but it does give the utility some assurance that its decision to incur project development costs, on the whole, will not be rejected in hindsight. In fact, avoiding hindsight review of the reasonableness and prudence of its decision to incur Lee Nuclear project development costs is precisely the rationale DEC's General Counsel espoused in the initial proceeding requesting Commission approval of those decisions:

> [L]et me just conclude by reiterating what we are requesting here: A finding that the work performed by Duke Energy Carolinas to ensure the availability of nuclear generation by 2016 for its customers is prudent and consistent with the promotion of adequate, reliable, economical utility service . . . , whether or not a new nuclear facility is constructed. We believe these findings are both fair and necessary, and the Commission has the authority to make these findings now. Having the Commission consider this issue at this time is best when Duke is making the decision, not later when everyone has the benefit of hindsight. The Commission should deal with this now when Duke must face the issue.

Statement of Ghartey-Togoe, *In re Duke Power Company, LLC*, Docket No. E-7, Sub 819, Tr. at 49 (Jan. 9, 2007).

But a request under G.S. § 62-110.7(b) is not without potential consequences for the utility. In particular, the Commission's review of a utility's request for approval of a

[16] The requirement that the public utility show "that the decision to incur project development costs is reasonable and prudent" appears to preclude post-hoc approval of a decision to incur nuclear project costs (that is, that the decision was reasonable and prudent) in a section 62-110.7(b) proceeding, notwithstanding the Commission's rulemaking order in *In re Rulemaking Proceeding to Implement Session Law 2007-397*, Docket No. E-100, Sub 113 (Feb. 29, 2008).

decision to incur nuclear project development costs also gives the Commission the opportunity to put the utility on notice that the Commission does not consider a decision to incur such costs to be reasonable and prudent. Stated another way, denial of a request under G.S. § 62-110.7(b) indicates that the utility's decision is not reasonable and prudent because that is the only permissible basis under the statute for such a decision; Commission approval is mandatory when reasonableness and prudence are shown. The Commission's 2008 Order confirms its understanding that an order under section 110.7(b) was a determination on reasonableness and prudence. Order Approving Decision to Incur Project Development Costs, Docket No. E-7, Sub 819 (June 11, 2008) ("the maximum amount of project development costs to be incurred on and after January 1, 2008, that are deemed to be included in a <u>reasonable and prudent decision</u> to incur project development costs is the North Carolina allocable share of a total system amount of $160 million ….")(emphasis added). A utility that barrels ahead with nuclear project development despite being unable to show that its decision to incur costs is reasonable and prudent should have no expectation that it will recover those costs; in fact, it is barred from doing so. This is especially true given that a Commission's ruling under G.S. § 62-110.7(b) is made on the basis of evidence presented by the parties in a contested hearing before the Commission; as DEC itself argued, the Commission's consideration of reasonableness and prudence of a decision to incur nuclear project development costs is best made before that decision occurs and "not later when everyone has the benefit of hindsight." *See* Order Denying Motion to Rescind Order Approving Decision to Incur Project Development Costs, Docket No. E-7, Sub 819, at p. (Aug. 25, 2008) (noting that a G.S. § 62-110.7(b) "proceeding focuses on whether it is reasonable for the Company to take steps in preparation for potential construction of [a nuclear] facility in light of the information known at the time").

Under DEC's interpretation of G.S. § 62-110.7(b), the Commission could conclude that a decision to incur costs was not reasonable or prudent based on the facts in existence at the time, but then later, with the benefit of hindsight, conclude that the fruit of that unreasonable and imprudent decision (specific items of cost) was reasonable and prudent. On the contrary, the very purpose of G.S. § 62-110.7(b) appears to be the prevention of post-hoc second guessing of this kind: the Commission's earlier finding that a decision to incur nuclear project development costs would be reasonable and prudent prevents later argument that the decision to incur nuclear development costs should not have been made. *Cf. State ex rel. Utilities Comm'n v. Carolinas Comm. for Indus. Power Rates & Area Dev., Inc.*, 257 N.C. 560, 570, 126 S.E.2d 325, 333 (1962) (holding that "specific questions actually heard and finally determined by the Commission in its judicial character are res judicata"). The utility's failure to show the Commission that the decision is reasonable and prudent in a proceeding pursuant to G.S. § 62-110.7(b) does not invite the utility to return for a second bite at the apple after imprudently incurring the costs but instead tells the utility <u>it should not spend the money in the first place or, if it does, it will not be permitted to recover those costs from ratepayers</u>. Certainly it was within DEC's prerogative to decide to make the expenditures in pursuit of its business objectives, but it cannot then come back to the Commission and expect to recover from ratepayers expenditures in excess of the Commission's authorization.

The Commission looked at the facts as they existed in 2011 and determined that DEC's application should be rejected and that such facts required significant limitations on

DEC's incurrence of nuclear project development costs. Specifically, the Commission found:

> It is appropriate for Duke to incur on and after January 1, 2011, only those nuclear project development costs that must be incurred to maintain the status quo with respect to the Lee Nuclear Station, including Duke's combined construction and operating license (COL) application at the Nuclear Regulatory Commission (NRC), up to a maximum of the North Carolina allocable portion of $120 million.

Order Approving Decision to Incur Limited Additional Project Development Costs, Docket No. E-7, Sub 819, at 4 (Aug. 5, 2011) ("2011 Order). The Commission denied DEC's request for approval of its decision to spend $283 million for the period January 1, 2010, through December 31, 2013, "in light of Duke's position that it will not proceed with construction absent legislation allowing recovery of CWIP financing costs outside a general rate case, and the fact that no such legislation is now pending before the General Assembly." *Id.* at 16. In further support of this decision, the Commission also found that a number of uncertainties undermined the reasonableness of continued spending on the Lee Nuclear project, including

> uncertainties related to the effectiveness of new demand-side management (DSM) and energy efficiency (EE) programs; whether carbon legislation will be enacted and, if it is, what form it will take and at what cost; whether and how much renewable energy will become available; . . . how well renewable technologies can be integrated into a utility's resource mix[;] . . . whether North Carolina will enact legislation that will allow Duke's rates to 'track' construction work in progress (CWIP) in a manner similar to legislation that has already been passed in South Carolina; the amount of load lost due to the recession that will not return and the extent to which growth in customer demand will occur as the economy improves; and any effect from the nuclear plant failures in Japan resulting from the earthquake and tsunami on March 11, 2011, on the timing and the construction costs of future nuclear plants and the costs related to spent nuclear fuel storage.

Id. at 3-4.

The Commission's findings proved to be prescient. The factors it noted are the same circumstances that ultimately caused DEC to abandon the project: lack of carbon legislation, low natural gas prices, relatively cheap and widely available solar power, lack of CWIP legislation, flat demand, and extraordinary delays and increased costs of nuclear construction resulting in part from the Fukushima Daiichi nuclear disaster. Based on the information in front of it in 2011—not the least of which was the consideration that Duke Energy's President and Chairman testified that DEC would not construct the facility in the absence of CWIP legislation—the Commission, acting at DEC's invitation under G.S. § 62-110.7, properly exercised its duty to limit DEC's decision to incur project development costs and to otherwise provide oversight.[17]

There are four critical aspects of the 2011 Order that bear emphasis as they differ significantly from the Commission's prior orders in Docket No. E-7, Sub 819. <u>First</u>, the 2011 Order expressly denies the application as submitted by DEC under G.S. § 62-110.7(b). <u>Second</u>, this Order limits its approval of a decision to incur project development costs to only those necessary to maintain "status quo." <u>Third</u>, it further limits its approval of a decision to incur such costs to a maximum of the North Carolina allocable portion of $120 million. <u>Fourth</u>, it does not limit the maximum amount to a particular time period going forward; rather it applies to all future decisions to incur costs.

[17] *See* Tech Customers Fallon Cross-Examination Exhibit 1 at Tab 11, Tr. Vol. 11, Exhibits, at 186 (excerpt from transcript of March 15, 2011 hearing in Docket E-7, Sub 819) (questions of Chairman Finley to Duke Energy's President Jim Rogers: "Q: Now if you don't get the legislation that you want in North Carolina in 2011, and you say that that's necessary for you to proceed with the Lee plant, I mean, at some point we've got to stop incurring the development costs, I would think. Is that correct? A: That's fair ….").

Despite the clear language in the 2011 Order notifying DEC that the Commission would not regard future spending on the project as "business as usual," there is no indication that DEC changed anything about its spending habits in light of the order. Its witnesses pay lip service to the notion that they limited spending to "status quo" expenses, but DEC's definition of "status quo" included all expenses necessary to bring the project online[18] (thus raising a question as to what DEC was spending money on prior to the limitations of the 2011 Order), and DEC's witnesses fail to point to any actual expenditures that were curtailed as a direct result of the limitations of the Commission's order. DEC continued to spend money on the same categories of costs that it identified prior to the order, and the overall rate of spending remained constant during 2011-2013. *See* Tr. Vol. 18, p. 173 (Kee Testimony, Figure 1).

More to the point, DEC's dogged pursuit of the COL was the most costly option available to it, and one that clearly was not authorized by the 2011 Order. The Commission did not elaborate in its order as to what activities would constitute maintenance of the status quo, but the plain meaning of the phrase is readily understandable—it means maintaining the current status. An order requiring a party to maintain the status quo does not authorize

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[18] In his rebuttal testimony, witness Fallon states: "To maintain the status quo, [DEC] began limiting its activities to only those activities and costs necessary to preserve the option of bringing the Lee Nuclear Project online around the target date." Similarly in DEC's Response to Tech Customers Data Request 4-42, which is attached as Exhibit C hereto, the Company states that it "considered the status quo as limiting activities and cost on the Project to only those necessary to preserve the option of bringing the Project online around the target dates established in the IRPs. This included maintaining an active status for the COLA at the NRC." But these explanations merely confirm the error of DEC's interpretation as this makes clear that the Company "interprets" the "restrictions" of the 2011 Order as permitting DEC to do everything planned to do before the issuance of the 2011 Order. The plain language of the 2011 Order makes it clear that the Commission was allowing the maintenance of the status quo, including the NRC application, not the status quo as to the targeted online date. Nowhere does DEC articulate how "maintaining the status quo of its application" could be reasonably interpreted as authorization to prosecute the license to completion.

the party to continue engaging in the very same <u>activities</u> it was engaging in prior to the order—as DEC did here. The whole purpose of an order requiring the maintenance of the status quo is to preserve the current status or situation so that the tribunal can gather more information for further decision without prejudicing any particular outcome. *See, e.g.*, Black's Law Dictionary, Tenth Ed. (defining "status quo" as "The situation that currently exists."); The American Heritage Dictionary, Third Ed. (defining "status quo" as "The existing condition or state of affairs."). Here the "status" as of the 2011 Order was a pending COL application at the NRC and investigation by DEC as to the feasibility of bringing a new nuclear facility online some 10-12 years in the future.[19] Maintaining the "status quo" of the NRC application could not possibly include prosecuting it all the way to issuance of the license. Any other interpretation robs the order of its meaning. The Commission acted with due regard to the interests of ratepayers in its 2011 Order by reigning in spending that was spiraling out of control and that was not reasonably likely to result in the establishment of used and useful assets. Subsequent events as to the Lee Nuclear project—and elsewhere, i.e., the V.C. Summer project—have proven the wisdom of the Commission's oversight and active engagement on the issue. That DEC has lost "only" $500 million on the abandoned project, as opposed to the some $9 billion spent by SCANA and Santee Cooper in South Carolina on the V.C. Summer project, is not an endorsement of DEC's prudent management practices. The fact remains that DEC has now spent over $1 billion at this one site between the potential Cherokee and Lee Nuclear projects and has yet to produce assets that are used and useful to ratepayers.

[19] DEC's own analysis showed no difference in the present value of revenue requirements impact between completion in the 2021 to 2023 time frame (10 to 12 years in the future, at the time of the 2011 Order) versus the 2026 time frame (15 years in the future). 2011 Order, at 21.

DEC's pleadings in this case present a practical evidentiary problem. DEC bears the burden of demonstrating its costs are recoverable, yet DEC has introduced no evidence—even after being confronted with the testimony filed by the Tech Customers—that the costs it seeks to recover are costs that have been authorized by the Commission.[20] *See* Tr. Vol. 18, p. 178-79. In light of DEC's failure to produce information permitting the Commission to determine that the costs DEC seeks to recover are within the limitations of the 2011 Order, one option for the Commission is to simply deny recovery of costs incurred after January 1, 2011, as DEC has not carried its burden. Another option is presented by witness Kee, who conducted an analysis of DEC's costs in order to approximate those costs associated with maintenance of the status quo, which he labeled "Type 1" costs. *See id.* Based on his review, witness Kee concluded that $73 million of total costs (excluding AFUDC) incurred after December 31, 2010 could reasonably be characterized as costs associated with maintenance of the status quo.

Setting aside that DEC failed to limit its post-2010 spending to "status quo" activities and has failed to provide evidentiary support permitting recovery of such costs, DEC's request has another basic problem—it is seeking recovery of some $333 million in costs when the 2011 Order limits costs incurred to maintain the status quo to a maximum of the North Carolina allocable portion of $120 million. The clear facts are that DEC elected to disregard the limitations of the 2011 Order, it "rolled the dice" by not seeking

[20] The study prepared by the Public Staff's consultant is of no help here. First, the study did not analyze whether costs were associated with maintenance of the status quo, particularly the status quo of the NRC application. Second, the study was not admitted into evidence for the "truth of the matter asserted" and, accordingly, may not be relied upon to carry DEC's burden. Regardless, as a legal matter, the costs that exceed those authorized by 2011 may not be recovered because they have already been deemed unreasonable and imprudent by the Commission.

clarification or review of the 2011 Order and by not filing another application seeking additional approval of its incurrence of project development costs, and it now hopes that the problem will go away by acting as if the 2011 Order did not exist—or that it does not mean what it says. DEC argues that it was not <u>required</u> by G.S. 62-110.7(b) to obtain the Commission's prior approval for these expenditures in order to later recover them, but that argument misses the point: DEC <u>did</u> seek Commission approval for its post-January 1, 2011 costs and did not obtain it because it was unable to show that its decision to incur costs would be reasonable and prudent, other than as strictly limited by the Commission. No new information has been provided. It would be error for this Commission to effectively overrule the findings of a prior Commission when that prior determination was factual in nature, no request for reconsideration was filed, no evidence was presented that the prior order was erroneous, and no showing was made that a different decision is justified.

DEC clearly understood the risks associated with its course of action. *See* Tr. Vol. 11, pp. 61-67. In a February 22, 2012 presentation, Duke Energy "[d]iscuss[ed] the risks and benefits" of seeking additional Commission approval for Lee Nuclear spending. Tr. Vol. 24, pp. 54-58; Tech Customers Fallon Rebuttal Exhibit 1. Among other things, the presentation notes the following as "[a]rguments against" seeking Commission approval of additional Lee spending (referred to as a "project development application" or "PDA"):

- "Filing a PDAs *(sic)* without CWIP legislation in place will place both [North and South Carolina] Commissions in a difficult spot"

- "Current projections for natural gas prices may negatively impact the business case for[] nuclear in the IRP placing both Commissions in a difficult spot"

- "Negative order may potentially place the whole project at risk from a regulatory perspective"

Tech Customers Fallon Rebuttal Exhibit 1 at p. 7. Thus, Duke Energy understood that the factors that led the Commission to limit DEC's decision to incur Lee Nuclear development costs in 2011 and going forward had not changed for the better, and that a negative order from the Commission could put the project at risk. *Id.*; *see* Tr. Vol. 24, p. 60. A May 1, 2013 presentation to Duke Energy's Finance and Risk Management Committee shows that Duke was considering the risks of nuclear development—including low and decreasing forecasted load growth, low and dropping natural gas prices, and increased nuclear facility construction cost estimates—all factors discussed by the Commission as problematic in its 2011 Order and all continuing to trend against continued nuclear development. Tr. Vol. 11, pp. 61-62; Tech Customers Fallon Cross Exhibit 1, Tab 8. Similarly, a December 9, 2013 report to the Finance and Risk Management Committee specifically notes that "one of the more significant reasons" the Commission limited its approval of project development costs was "Duke Energy's statement during questioning by the NCUC that DEC will not proceed with construction of Lee without the passage of additional cost-recovery legislation in North Carolina that would allow recovery of the financing costs associated with nuclear construction outside of a general rate case, coupled with the fact that no such legislation was pending before the NC General Assembly." Tech Customers Fallon Cross Exhibit 1, Tab 9; Tr. Vol. 11, pp. 62-66. The report further notes that the Commission's 2011 Order limits its approval to "only those nuclear project development costs that must be incurred to maintain the status quo with respect the Lee Station" and highlights the Commission's admonition that "Duke is on notice that the Commission's limited approval … cannot be interpreted as making it probable at this time that the recovery of any specific actual costs will be allowed." *Id.* An accompanying presentation discusses the projected costs of the Lee Nuclear project and notes that some $218 million is "at risk if additional PDOs are not requested and approved." Tech Customers Fallon Cross Exhibit 1, Tab 9; Tr. Vol. 11, pp. 66-67.

These internal reports show that Duke was carefully tracking its expenditures on the Lee Nuclear project, that it knew that it was exceeding the limitations in the 2011 Order, that it knew that a bona fide question existed as to whether it was limiting its expenditures to "status quo" expenditures, and that it was uncertain whether it would be able to recover all of its expenditures. As shown above, the option of seeking additional or less limited project development approval from the Commission was repeatedly considered, yet ultimately DEC chose to proceed in the face of these risks.

No provision of the Commission's statutory authority allows the recovery of costs that are not reasonable and prudent, as DEC's witness admits. *See, e.g.,* Tr. Vol. 24, p. 73.[21] DEC's request for recovery of its Lee Nuclear expenditures after January 1, 2011, in excess of the North Carolina allocable portion of the $120 million spending cap is beyond the Commission's authority to grant, and it should be denied.

Aside from seeking additional authority from the Commission, there were multiple paths that DEC could have taken to curtail expenditures on the Lee Nuclear project in a manner consistent with the 2011 Order, but DEC chose none of them and, instead, continued marching down the path it was on. For example, the DEC COL application

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[21] The Public Staff cross-examined DEC witness Fallon as follows: "Q: The Company is never allowed to incur costs that aren't reasonably and prudently incurred, is it? A: I'm not a regulatory expert, but I don't think so. Q: And G.S. 62-110.7 does not alter that basic regulatory construct at all, does it? A: No, I don't believe it does ….". *See also id.*, p. 71 (discussing internal Duke analysis acknowledging that "the Company and its investors bore the risk that certain costs incurred for project development activities may be found to be imprudent.").

could have been suspended in 2011 (or at any time thereafter), which would have (1) maintained the status quo, and (2) stopped DEC from incurring additional costs. *See, e.g.*, Tr. Vol. 18, pp. 193-94, 197-99.

DEC witness Diaz testified to the effect that DEC's COL has value resulting from its "capability of deploying a nuclear power plant when most beneficial" and asserts that this is a "readily available asset for DE Carolinas." Tr. Vol. 10, p. 250. Any "value" derived from the COL's "ready availability" is illusory, however, as DEC had admitted that the Lee Nuclear project is not needed in the next 15 years except under limited planning assumptions. Tr. Vol. 10, p. 186. Moreover, if the volatile history of the nuclear power industry over the last 11 years is any guide, it is speculative to suggest that a COL issued in 2016 would be allowed to continue in force for decades. Witness Diaz's suggestion that there is value in the "finality" of the Lee COL and that "a suspended license application is subject to all new conditions . . . while an issued COL is valid as approved," Tr. Vol. 26, p. 185-87, elides the very real prospect that changes will be required. Federal law provides that: "Any license may be revoked . . . because of conditions revealed by . . . any report, record, or inspection or other means which would warrant the Commission to refuse to grant a license on an original application . . . ." 42 U.S.C. § 2236(a). Thus, the Lee COL is subject to continuing review, revocation, and modification under the NRC's evolving regulatory standards in precisely the same manner as a new or pending application. *Ft. Pierce Utilities Auth. of City of Ft. Pierce v. United States*, 606 F.2d 986, 996 (D.C. Cir. 1979) (finding Congressional intent to render licenses subject to post-licensing review under evolving licensing standards); *see Massachusetts v. U.S. Nuclear Regulatory Comm'n*, 708 F.3d 63, 80–81 (1st Cir. 2013) (noting the NRC's authority to review, revoke, modify, and suspend licenses in light of the Fukushima Daiichi disaster); *see also* 10 C.F.R. § 2.206(a) (permitting individuals to petition the NRC for a determination whether a license should be modified, suspended, or revoked). Thus, a COL which the holder does not intend to use in the near future has no greater value than a suspended license application because both will be subject to exactly the same ongoing scrutiny.[22]

DEC witness Diaz also suggests that the COL has value because the Lee Nuclear site has completed its environmental screening. Tr. Vol. 26, p. 187. However, as Tech Customers witness Kee explained, DEC could have obtained the benefit of a pre-screened reactor site by obtaining an early site permit without going to the expense of obtaining a COL. Tr. Vol. 18, p. 199.

In any event, that DEC has now obtained the COL is immaterial to the pending issue. DEC did not request approval of a decision to incur costs to "bank" the COL; if it had done so, the Commission would have been in a position to assess the prudency of a decision to incur the costs necessary to achieve this result. In this regard, DEC's assertion that the value of the "banked" COL now justifies the costs above the dollar limit imposed by the Commission is nothing more than a request by DEC that this Commission second guess, indeed, re-write, the 2011 Order—albeit based on facts even less favorable to nuclear power development than those before the Commission in 2011.

DEC has disregarded the limitations of the 2011 Order—both the cap and the restriction to only maintain the status quo. *See* Tr. Vol. 18, pp. 174-76, 180-90 (Tech

[22] *See* Tr. Vol. 18, pp. 201-04 (Tech Customers witness Kee testifying that Diaz mistakenly assumes the Lee project will be built in the near future when it reality it will not, and "the more time that passes between the Lee COL approval date . . . and the time when a decision to proceed to construction is made, the more time and money will be needed to modify the COL . . . and obtain NRC approvals for these modifications").

Customers witness Kee discussing DEC's failure to comply with the spending cap and "status quo" requirement). DEC was free to seek reconsideration of the 2011 Order (it did not); it was free to seek to reopen the record based on new evidence (it did not); it was free to file a new application for authorization under G.S. 62-110.7(b) (it did not). The one path not available to DEC is the path it is pursuing in this proceeding: having invoked the statutory procedure of G.S. 62-110.7(b), it cannot now reset the clock back to 2010 and pretend the 2011 Order does not exist.

C. No return should be allowed on the unamortized portion of DEC's costs.

Whatever Lee Nuclear costs the Commission allows DEC to recover, consistent with the Public Staff's position, DEC should not be allowed to earn a return on the unamortized portion of those costs. 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.

Because the Lee Nuclear project has been canceled, there are no "used and useful" assets that would justify granting DEC a return. *See* N.C. Gen. Stat. § 62-133(b)(4). Therefore, it is more appropriate to treat these costs as operating expenses, for which no return is allowed. N.C. Gen. Stat. § 62-133(b)(5).

This result is consistent with past Commission practice, 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 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 has failed to articulate any principled basis for departing from this established precedent. The fact that DEC has obtained a COL does not alter the analysis, given that the COL will not be used and useful within the near future.

Finally, it should be noted that even if the Commission finds that G.S. § 62-110.7(d) applies in this proceeding, that section 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.

D. The Commission should exercise its prudential authority to limit DEC's recovery of other costs.

In setting DEC's rates, the Commission has authority to consider all material facts to determine what ultimately constitute just and reasonable rates. N.C. Gen. Stat. § 62-133(d). The Commission should use this authority to constrain some of the costs DEC seeks to recover, including AFUDC accrued late in the life of the Lee Nuclear project and the costs incurred by DEC in 2010.

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 cancelling 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, as 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, 1982 WL 993428 (N.C.U.C. Nov. 1, 1982). Here, section 62-110.7 confusingly provides that DEC may recover an "allowance for funds used during construction associated with" non-construction activities. Whatever the General Assembly meant, it surely did not mean that this Commission should allow DEC to pour funds into a hypothetical nuclear facility—one that the company admittedly had no present intent to construct—and then make ratepayers pay unlimited carrying costs while DEC waits to someday decide whether to proceed.

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) (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).[23] 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. In other words, 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, it would be reasonable for the Commission to conclude—based on the testimony of Duke Energy's President in 2011 that DEC would not construct the project without CWIP legislation, coupled with the fact that there was no such legislation proposed, much less passed—that construction of the project was effectively abandoned as of the date of the 2011 Order. 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. *See, e.g.,* Public Staff Fallon Rebuttal Cross Examination Exhibit 2, at 7 (Tr. Vol. 24, pp. 68-70); 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

[23] 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); *see also 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.").

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 dating from that point.

Therefore, the Commission should disallow recovery of 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.

Finally, as to the costs incurred by DEC in 2010, the Commission denied in the 2011 Order DEC's request that the Commission find that incurring those costs was reasonable and prudent. It is unclear whether the Commission had any authority to review those costs in a proceeding pursuant to G.S. 62-110.7(b) after they were incurred. *See* footnote 16, *supra*. Should the Commission determine here that the Commission's rejection of the 2010 costs was a determination that such costs were not part of a reasonable and prudent decision to incur costs—as opposed to a decision that the request was not properly made under G.S. § 110.7(b) given that the period had already passed and the costs had presumably been incurred—then there would be no factual or legal basis for deciding the issue differently in this proceeding. *See* Tr. Vol. 18, p. 178 (Tech Customers witness Kee questioning whether that DEC should be permitted to recover its 2010 costs).

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In summary, based on the foregoing, the Commission should adjust DEC's claimed costs for the Lee Nuclear project as follows:

1. DEC should only be allowed to recover the North Carolina allocable share of actual costs, including AFUDC, incurred in the period up to December 31, 2009, if those actual costs were less than the not-to-exceed limits in the 2007

Order and the 2008 Order. Based upon DEC's filings, this is the North Carolina allocable share of $172,002,979, including AFUDC.[24]

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

3. DEC should only be allowed to recover costs of the Lee Nuclear project after January 1, 2011, if 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 could take either of the following actions consistent with its 2011 Order:

    a. Deny recovery of any costs incurred on or after January 1, 2011, reflecting the failure of DEC to demonstrate that any activities in this period were required to maintain the status quo; or

    b. Allow only the costs during this period most closely identified with maintenance of the "status quo" (identified as Type 1 costs by Tech Customers witness Kee), which is the North Carolina allocable share of $73,111,397 without AFUDC.

    Regardless, the Commission should disallow all recovery above the North Carolina allocable share of the $120 million not-to-exceed cap, including AFUDC.

IV. DEC 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.

In DEC's prior rate case four and a half years ago, the Commission approved a return on equity ("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 discounted cash flow ("DCF") analysis, "particularly as it

[24] DEC implies that the Commission's spending authorizations in Docket No. E-7, Sub 819 were cumulative. They were not. They were for specific periods, which requires matching the date costs were incurred with the period for which the costs were authorized. Because the first two orders in Sub 819 imposed time limits as well as dollar limits, unused "headroom" under the caps do not carry over to the next period. *See, e.g.*, Docket No. E-7, Sub 819, Tr. Vol. 1, p. 73 (April 29, 2008) (DEC counsel represents to Chairman in response to question that "headroom" under cap does not carry forward to new request for authorization).

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, Mr. Hevert advocated that the Commission *increase* DEC's ROE from 10.2% to 10.75%.[25]

The DCF empirical models Mr. Hevert set out in his testimony—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*

[25] Shortly before the hearing in this proceeding commenced, the Public Staff and DEC presented to the Commission for its consideration a partial settlement, which includes a proposed stipulated ROE of 9.9%. *See* Agreement and Stipulation of Partial Settlement, Docket No. E-7, Subs 1146, 819, 1110, 1152 (Feb. 28, 2018). Mr. Hevert testified that if the rate case were litigated, he would adhere to his recommended ROE of 10.75%. *See* Tr. Vol. 4, pp. 408–09.

Electric Utility Service in North Carolina, Docket No. E-22, Sub 532, Tr. Vol. 20, pp. 13–14.

Given this gulf between Mr. Hevert's targeted ROE recommendation and the objective evidence at hand, he essentially jettisoned the results of his empirical models in favor of focusing upon what he contended was DEC's higher risk profile. After walking through the results of his empirical model, 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, Mr. Hevert's resort to risk analysis is as suspect as his abandonment of the results of his empirical models. The objective evidence in the record refutes Mr. Hevert's premise that DEC presents a higher risk profile to equity investors than the proxy group and his related conclusion that DEC is entitled to an upward departure from the empirical models (and recently authorized ROEs). 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*,[26] the ROE figure Mr. Hevert advances in his testimony is excessive.

[26] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943) (*Hope*), and *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.,* 262 U.S. 679 (1923) (*Bluefield*), respectively.

The Tech Customer's witness Kurt Strunk outlined several measures of risk in his testimony and exhibits, and none suggest that DEC presents a higher risk profile than the proxy group companies. For example, Moody's and Fitch have issued DEC credit ratings of A1 and A, respectively. *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*. The Business Risk rating assigned to DEC's parent Duke Energy Corporation by Standard & Poor's is "Excellent," which is the highest rating and higher than ratings received by the holding companies 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. *See* Tr. Vol. 4, pp. 474–75. Standard & Poor's Financial Risk rating for DEC's parent places DEC squarely in line with the utilities in the proxy group from a risk standpoint – with all but two of these holding companies receiving the "Significant" rating. *See* Testimony of Kurt Strunk, p. 41–42; Tech Customers Ex. KGS-8; Tr. Vol. 4, p. 475. Taken together, these 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, pp. 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 the proxy group companies—and refute Mr. Hevert's position to the contrary. Value Line's estimated betas for each of the holdings companies of utilities in 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 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 of 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. See, e.g., 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 to the risk 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. *See* Tr. Vol. 4, pp. 111, 465.

Critically, Mr. Hevert was unable to point to any objective measure indicating DEC is comparatively riskier 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. *See* Tr. Vol. 4, pp. 483–84. As a result, Mr. Hevert relied solely upon 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.[27] This approach

[27] 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

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." 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 are not based upon the required assessment of 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 proposed ROE, the mathematical convenience of the stipulated ROE is insufficient justification, standing alone, for its adoption when one of those proposals—here Mr. Hevert's—lacks any objective indicia of a rational basis.

A utility advocating an ROE figure that substantially exceeds the output of widely recognized empirical models and that also exceeds recently authorized ROEs should be required to justify the excessive ROE with a quantitative analysis that shows the utility'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

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Staff stipulated ROE of 9.9% *still* represent upward departures from these reference points without any underlying empirical justification. *See* Tech Hevert Ex. 2.

do the companies of the proxy group, even the smaller upward departure lacks sufficient record support.

CONCLUSION

For the reasons discussed above, the Tech Customers respectfully request that the Commission enter an order:

- Denying DEC's request for implementation of a proposed "Grid Reliability and Resiliency" Rider as well as its alternative request for establishment of a regulatory asset.
- Requiring DEC to pass through the benefits of the 2017 Tax Act directly to ratepayers by lowering rates to reflect the reduced federal income tax rate and returning tax overcollections (EDIT) to ratepayers in the manner proposed by the Public Staff.
- Limiting DEC's recovery of costs related to the Lee Nuclear project to those post-January 1, 2011 costs necessary to maintain the status quo, to the extent such costs do not exceed the North Carolina allocable share of $120 million, denying DEC's request for a return on the unamortized portion of permitted costs, and otherwise adjusting DEC's request as specified above.
- Finding that DEC has failed to adequately support either the return on equity figure sought in its application for a general rate case or the return on equity to which it stipulated with the Public Staff.

Respectfully submitted, this 27th day of April, 2018.

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Certificate of Service

I hereby certify that a copy of the foregoing *Post-Hearing Brief 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

Exhibit A

Comparison of Traditional and Power/Forward Spend

Comparison of Traditional and Power/Forward Spend

Class of Investment	**Characterized by DEC as Traditional T&D investment (Customary Spend)**	**Characterized by DEC as Eligible for Power/Forward Carolinas Rider**
Security	"cyber security and physical security programs" (Simpson Direct, p.10, line 17)	"physical and cyber security" (Simpson, Exhibit 2, p.1)
Capacity	"the $3.4B includes capacity increases to distribution circuits and T/D substations for load growth." (IR 2-8)	"adding capacity to distribution circuits and substation transformers" (Simpson, p.29, line 21)
Transformer Retrofit	"transformer retrofit program to reduce the number of outages per 100 line miles and reduce the impact on customers due to equipment failure and animal intrusion" (Simpson Direct, p.22, line 5)	"retrofitting transformers to eliminate common outage causes" (Simpson, p. 27, line 13)
Sectionalization	"sectionalization programs designed to reduce the impact of outages on customers" (Simpson Direct, p.22, line 8)	"sectionalization" (Simpson, Exhibit 2, p.1)
Urban Renovation	"urban renewal projects" (Simpson Direct, p.13, line 1)	"urban UG uplift" (Simpson, Exhibit 2, p.1)
Replacement of Grid Components	"the replacement of deteriorated wood poles and replacement of obsolete substation and line equipment" (Simpson Direct, p.10, line 21) "replacement of capital units of property during routine outage events, the relocation of lines to accommodate highway projects,…and conductor replacements." (Simpson Direct, p.12, line 22) "distribution line rebuilds and relocations, as well as programs to replace equipment like house power panels that have reached the end of life" (Simpson Direct, p.12, line 19)	"replacing aging components like transformers, cables and conductors" (Simpson, p.6, line 14)
Undergrounding	"pole replacement and underground cable replacement" (Simpson Direct, p.12, line 5) "underground primary cable replacement where outage history and cable analysis predict failures" (Simpson Direct, p.12, line 17)	"targeted undergrounding" (Simpson, p.25, line 10)

Automated Outage Isolation	"self-healing teams that apply state-of-the-art technology to automatically isolate the cause of an outage and restore service to customers." (Simpson Direct, p.12, line 11)	"the grid can self-identify problems and react to them by isolating affected areas and automatically rerouting power, shortening or even eliminating outages for many customers." (Simpson, p.30, line 6)
Outage Mitigation	"prevent line and transformer overloads that could occur during certain failure contingencies on the transmission system." (Simpson Direct, p.10, line 5) "adding many breakers to reduce the likelihood of customer outages and improve operating flexibility." (Simpson Direct, p.10, line 8) "identify and resolve physical limitations that might prevent lines from being operated at required capacity" (Simpson Direct, p.10, line 16)	"reducing the number of customers affected by an outage; and reducing duration" (Simpson, p.6, line 16) "customers experience less interruptions" (Simpson, Exhibit 2, p.1)

Source: Testimony of Kurt Strunk, Tr. Vol. 26, at pp. 477-78, at Table 3: Customary Network Investments *vs.* Power/Forward Carolinas

Exhibit B

DEC Response to Tech Customers Data Request 4-7

Duke Energy Carolinas
Response to
Tech Customers
Data Request No. Tech Customers 4-7

Docket No. E-7, Sub 1146

Date of Request: **December 19, 2017**
Date of Response: **December 29, 2017**

☐ **CONFIDENTIAL**

☒ **NOT CONFIDENTIAL**

Confidential Responses are provided pursuant to Confidentiality Agreement

The attached response to Tech Customers Data Request No. 4-7, was provided to me by the following individual(s): Erik G. Wagner, Manager, Nuclear Engineering, and was provided to Tech Customers under my supervision.

Heather Smith
Deputy General Counsel
Duke Energy Carolinas

Tech Customers 4-7

Request:

Identify any provision of law requiring DEC to obtain Commission approval for cancellation of the Lee Nuclear project.

Response:

See G.S. §62-110.7(d).

Exhibit C

DEC Response to Tech Customers Data Request 4-42

Duke Energy Carolinas
Response to
Tech Customers
Data Request No. Tech Customers 4-42

Docket No. E-7, Sub 1146

Date of Request:	**December 19, 2017**
Date of Response:	**January 12, 2018**

☐ **CONFIDENTIAL**

☒ **NOT CONFIDENTIAL**

Confidential Responses are provided pursuant to Confidentiality Agreement

The attached response to Tech Customers Data Request No. 4-42, was provided to me by the following individual(s): Erik G. Wagner, Manager, Nuclear Engineering, and was provided to Tech Customers under my supervision.

John Burnett
Deputy General Counsel
Duke Energy Carolinas

Tech Customers 4-42

Request:

Witness Fallon states the following at page 21, lines 7-13 of his testimony: "To suspend the pursuit of the COL with the NRC because the preauthorization amount had been reached would have eliminated the benefit of DE Carolinas's efforts to decrease the long lead time for new nuclear plant construction by forfeiting DE Carolinas's place "in line" for its COLA review when it had already completed a significant portion of the requirements necessary to obtain a COL." With respect this statement:

(1) Explain why DEC would have suspended the COL application because the preauthorization amount had been reached.
(2) Confirm that there was not a formal "place in line" for the W.S. Lee COL NRC review and that the informal "place in line" for the W.S. Lee NRC review was near the end of the line.
(3) Compare how a suspension of the W.S. Lee COL application at the time the preauthorization amount cap was reached (i.e., with completion of COL review done later) would impact the schedule for the W.S. Lee project if or when approval were granted to build the plant as compared to the current situation (i.e., with an approved COL).
(4) Given the need to update the approved COL to reflect a range of factors, including updates to the AP1000 standard design, how would the overall schedule for the W.S. Lee project differ between two scenarios: (a) suspending the COL application in about 2014 and completing the review later prior to construction, or (b) banking the 2016 approved COL and updating it later prior to construction.
(5) Explain how the DEC strategy to "decrease the long lead time" for nuclear construction is consistent with the 2011 order that called for DEC "to incur only those nuclear project development costs that must be incurred to maintain the status quo with respect to the Lee Station, including Duke's COL application at the NRC."

Response:

(1) The intent of the testimony is to describe why the COL was not suspended when the pre-authorization amount was reached.

(2) Please see response to DR TC 4-19.

(3) Suspension of the COLA would have prevented the Company from meeting the IRP specified in-service dates and resulted in a delay of unknown duration. See also DR TC 4-12.

(4) Please see response to DR TC 4-12.

(5) The Company considered the status quo as limiting activities and cost on the Project to only those necessary to preserve the option of bringing the Project online around the target dates established in the IRPs. This included maintaining an active status for the COLA at the NRC.