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OFFICIAL COPY

August 25, 2016

Via Hand Delivery
Ms. Gail L. Mount, Chief Clerk
North Carolina Utilities Commission
Dobbs Building, Fifth Floor
Raleigh, NC 27603

Re: Docket Nos. E-2, Sub 1095, E-7, Sub 1100, and G-9, Sub 682

Dear Ms. Mount:

Enclosed for filing in the above-referenced matter on behalf of The Public Works Commission of the City of Fayetteville are an original and 30 copies of its Brief. Kindly date-stamp and return to us via our courier the additional enclosed copies. Please do not hesitate to telephone me with any questions concerning this matter.

Sincerely,

West Law Offices, P.C.

By: _____
James P. West

Enclosures

cc: All Parties

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-2, SUB 1095
DOCKET NO. E-7, SUB 1100
DOCKET NO. G-9, SUB 682

In the Matter of	)
	)
Application of Duke Energy Corporation and	)
Piedmont Natural Gas Company, Inc. to Engage in	)
a Business Combination Transaction and Address	)
Regulatory Conditions and Code of Conduct	)

BRIEF OF THE PUBLIC WORKS COMMISSION
OF THE CITY OF FAYETTEVILLE

The Public Works Commission of the City of Fayetteville ("FPWC"), an intervenor, is filing this Brief for the purpose of both addressing the potential anti-competitive impact of the proposed business combination transaction involving Duke Energy Corporation and Piedmont Natural Gas Company, Inc. ("Piedmont") and proposing a viable means for mitigating the risk of such an anti-competitive impact. To be clear, FPWC is not asking the Commission to deny the proposed merger, but FPWC is seeking to maintain a fair, level playing field for retail consumers of natural gas from Piedmont who also sell electricity in the competitive wholesale market.

The Commission has previously ruled that in order to determine whether a proposed merger is justified by the public convenience and necessity pursuant to G.S. 62-111, the Commission will evaluate whether a merger will have an adverse impact on rates and service, whether ratepayers are protected as much as possible from potential costs and risks of a merger, and whether sufficient benefits arise from a merger that offset potential costs and risks. See In re Application of Duke Energy Corp. for Authorization under G.S. 62-111 to Enter into a Business Combination Transaction with Cinergy Corp.

and for Approval of Affiliate Agreements under G.S. 62-153, Order Approving Merger Subject to Regulatory Conditions and Code of Conduct, Docket No. E-7, Sub 795 at p. 75 (Issued March 24, 2006); see also Application of Duke Power Co. for Authorization under North Carolina General Statute Sections 62-111 and 62-161 to Engage in and to Issue Securities in Connection with a Business Combination Transaction with Pan Energy Corp., Order Approving Merger and Issuance of Securities (Issued April 22, 1997). Certainly, in order to satisfy the public convenience and necessity standard, a material risk of an anti-competitive impact on utility customers imposed by a proposed merger must be mitigated sufficiently so that the utility customers are no worse off after the merger than they were before the merger.

FPWC owns natural gas-fired generation capacity, for which FPWC contracts to purchase natural gas from Piedmont on a retail basis. When FPWC's current wholesale electric power purchase arrangement ends, FPWC will be able to sell electric power from its natural gas-fired Butler-Warner generation plant in the wholesale electric market in direct competition with Duke Energy Progress, LLC ("DEP") and Duke Energy Carolinas, LLC ("DEC") (Piedmont, DEP, and DEC are collectively the "Applicants"). If Piedmont is acquired by the parent company of DEP and DEC, FPWC may be unable to compete effectively in the wholesale electric generation market with DEP and DEC if DEP and DEC are able to acquire natural gas from or through their affiliate, Piedmont, on terms that are more favorable than those that are available from Piedmont to FPWC. Prior to a merger, Piedmont would have had no incentive to discriminate against FPWC in favor of DEP or DEC,[1] but after the proposed merger with Duke, the combined

[1] This fact was confirmed in the cross-examination of James Reitzes, Ph.D., one of the Applicant's witnesses, in the following exchange:

companies have a financial incentive to discriminate against FPWC in favor of DEP and DEC because such discrimination will allow DEP and DEC to succeed in competing with FPWC in the wholesale electric market by increasing the gas delivery costs of FPWC's gas-fired generation in relation to the costs borne by DEP and DEC.

This is an important issue because, as the Applicants acknowledge in their merger application:

> the direct use of natural gas will become an even more important energy source based upon the current gas forecasts, the current direction of federal environmental regulations, and customers who will have more options when it comes to energy consumption. (Application ¶18).

In the application for approval of the proposed merger, the Applicants sought to alleviate concerns about potential anti-competitive favoritism by proposing a Code of Conduct that mandated: "for gas supply transactions, transportation transactions, or both, between DEC and Piedmont or DEP and Piedmont, Piedmont shall provide service to DEC or DEP at the same price and terms that are made available to other similarly situated shippers." Proposed Code of Conduct ¶ III.D.3(e). Unfortunately such a provision in the Code of Conduct simply begged the question who or what is a "similarly situated shipper" that could avail itself of such protection.

When confronted with this issue in a motion to compel filed by FPWC in this proceeding, the question of who or what is a "similarly situated shipper" was not answered, but the Commission acknowledged that "the fact that the rates Piedmont presently charges DEC and DEP for service to electric generating units differ" . . .

Q Prior to the merger was there any risk to a municipal customer or an electric co-op of being concerned that Piedmont might be discriminating against them in relation to another electric generator like Duke Energy Carolines or Duke Energy Progress?
A I don't know. To my knowledge, no. (Tr. 2 at p 116.)

"suggests that 'similarly situated' is a concept difficult to litigate in the context of the issues under review in these dockets." Order Denying Motion to Compel at page 5 (issued May 23, 2106). Presumably in response to implicit concerns about the viability of a definition of the phrase "similarly situated," the Applicants subsequently filed a revised proposed Code of Conduct as part of their settlement stipulation with the Public Staff that eliminated references to "similarly situated shippers" in ¶ III.D.3(e) in favor of the following:

> All Piedmont deliveries to DEC and DEP pursuant to intrastate negotiated sales or transportation arrangements and combinations of sales and transportation transactions shall be at the same price and terms that are made available to other Shippers having comparable characteristics, such as nature of service (firm or interruptible, sales or transportation), pressure requirements, nature of load (process/heating/electric) generation, size of load, profile of load (daily, monthly, seasonal, annual), location on Piedmont's system, and costs to serve and rates.

While the Applicants and the Public Staff provided a listing of general factors that are relevant to an assessment of whether two shippers have "comparable characteristics," the proposed Code of Conduct remains significantly deficient as a means of protecting customers such as FPWC from potential discrimination in natural gas pricing for four primary reasons: (1) The standard is, by its terms, applicable to Shippers rather than generating units of Shippers. "Shipper" is defined by the Applicants in the Code of Conduct as a marketer, a municipal gas customer, or an end-user of gas, Proposed Code of Conduct ¶ I, even though the determination of "comparability" for setting negotiated rates is made at the generating unit level rather than the Shipper level, as Duke admitted on cross-examination, (Tr. 3 at p. 20-21), and as the Commission itself observed when it commented in the Order Denying Motion to Compel that "the rates Piedmont presently charges DEC and DEP for service to electric generating units differ"; (2) Even with the

articulation of several "factors," the legal standard set forth in the Code of Conduct is overly vague, as demonstrated by answers given by the Applicant's witness on cross-examination, (Tr.3 pp. 23-25 (for example, according to Piedmont Vice President - Regulatory Affairs, Rates and Gas Cost Accounting, Bruce Barkley:

> So I think it's just, again, given as something that can differentiate customers, the size. You would need larger facilities to serve a larger customer. That might also be offset, though, Mr. West, by the benefits that a very large customer could bring. So, you know, in terms of a rate, I think the size needs to be considered, but I think we would -- it would be situational as to whether, you know, the exact effect it would have. (Tr. 3, p. 24));

(3) Since the negotiated rate agreement with each shipper and any supporting documents are filed confidentially, (Tr. 2 pp. 115-16), each shipper is ignorant as to the negotiated rates made available to other shippers, leaving a shipper unable to determine with any reasonable confidence whether the shipper has been the victim of undue discrimination in the setting of negotiated rates; and (4) reliance on the Code of Conduct (or, in the alternative, G.S. 62-140) to prevent undue discrimination will shift the burden of proof to FPWC or any other shipper that may receive unfair treatment by Piedmont. See State ex rel. Utilities Comm. v. Edmisten, 314 N.C. 122, 151, 333 S.E.2d 453, 471 (1985), vacated Nantahala Power & Light Co. v. Thornburg, 477 U.S. 902, 106 S.Ct. 3268, 91 L.Ed.2d 559 (1986).

The Applicants offered the testimony of economist James Reitzes, Ph.D., of The Brattle Group, in an attempt to allay concerns about the anti-competitive impact of the merger. Dr. Reitzes acknowledged in his market report that:

> There are two mechanisms by which the merged firm would, theoretically, be able to raise the cost of third party generation to supply power in North Carolina: (i) any actions which Piedmont, in its capacity as the franchised LDC, might take to increase the deliver price of gas to generating units

> connected to Piedmont's distribution system or a Piedmont-owned lateral; . . . (Report p. 29.)

According to Dr. Reitzes, "munis and co-ops in North Carolina own four gas generation plants that are each directly connected to Piedmont's gas distribution network." (Id.) One of the four plants he referenced is FPWC's Butler-Warner facility, which according to Table 10 of his report, is comprised of 185 MW of combined cycle capacity and 40 MW of combustion turbine,[2] and is "tolled to Duke" until 2019 in an arrangement in which Duke is responsible for paying for the gas consumed by the Butler-Warner facility. (Report p. 30; Tr. 2 p. 119). Dr. Reitzes concluded that "third-party generation is not at risk of higher gas costs related to changes with respect to Piedmont's gas distribution network" because "Duke already controls (or owns the output from) most of the muni/co-op capacity," in addition to the fact that "muni and co-op generation is comprised of peaking facilities with low capacity factors" and Duke therefore does not have a significant financial incentive to increase gas costs to the third-party generators. (Report p. 30; Tr. 2 pp. 121-22.)

His conclusions about the risk of anti-competitive conduct are both: (1) inadequate because he failed to assess the potential anti-competitive impact of the merger when the Butler-Warner facility is no longer subject to a "Duke tolling agreement," which is scheduled to occur in a few years according to his own report; and (2) inaccurate because he ignored the fact that Butler-Warner's combined cycle capacity is capable of serving as an intermediate generating unit

[2] On cross-examination, Dr. Reitzes acknowledged that his table's description of Butler-Warner's generating capacity may be incorrect. (Tr. 2 p. 118.)

rather than peaking unit, which therefore provides a material incentive to increase the cost of gas delivered to FPWC's Butler-Warner facility. Since the risk of Piedmont acting to raise the cost of third-party generation to supply power in North Carolina has been effectively acknowledged by Dr. Reitzes, and his market power report does not identify sufficient mitigation of that risk, FPWC and other electric generators who purchase retail service from Piedmont have only Section III.D.3(e) of the Code of Conduct and the enforcement of G.S. 62-140, which prohibits undue discrimination, as potential bases to seek protection in the event discrimination occurs. In fact, in the Order Denying Motion to Compel issued May 23, 2016, the Commission has already announced that "[t]o the extent FPWC determines in future negotiations with Piedmont that Piedmont is acting in a discriminatory manner, FPWC will have the opportunity to bring its complaint to the Commission at which time the Commission will be able to address the facts at issue forming the basis of FPWC's complaint." (Order p 5.)

Of course, the shortcoming inherent in FPWC's opportunity to bring a complaint to the Commission that Piedmont is acting in a discriminatory manner is that FPWC will bear the burden of proof in a forum in which relevant information will be unavailable to FPWC prior to filing the complaint due to confidentiality restrictions and perhaps even after the complaint is brought if FPWC's attempts to obtain discovery are thwarted. The imposition of this burden of proof is a risk imposed upon FPWC and other shippers as a direct result of the merger because, as Dr. Reitzes acknowledged, there was no risk of anti-competitive behavior prior to the proposed merger. The notion that FPWC or

another shipper should bear the burden of presenting and then proving a violation of either the Code of Conduct or G.S. 62-140 without access to the information relevant to the determination of whether a violation has occurred, specifically the confidentially filed contractually negotiated rates of other shippers, thus seems both unfair and unworkable.

Proposed Code of Conduct Section III.D.3(e) does require Piedmont to "maintain records in sufficient detail to demonstrate compliance with this requirement," but Mr. Barkley stated that Piedmont would only create and retain as confidential a spreadsheet and notes rather than a report. (Tr. 3 pp 26-27.) The requirement to maintain records, standing alone, provides no real benefit to FPWC and other shippers in attempting to assess whether discrimination has occurred if such records are not available to them. While FPWC understands and respects the need to maintain customer-specific data and negotiated rates as confidential, FPWC does not believe that the proposed regulatory system will provide shippers with sufficient protection to adequately offset the anti-competitive risks presented by the proposed merger.

In order to create a viable, fair system to prevent anti-competitive conduct, Section III.D.3(e) of the Code of Conduct should be modified significantly. First, the definition of "Shipper" should be clarified to allow the determination of comparability and discrimination to be made at the generating unit level for the Shippers and the Applicants. Second, Section III.D.3(e) should require Piedmont to utilize a uniform model to develop negotiated rates and, third, Piedmont should be required to prepare a comprehensive narrative report and quantification for

each negotiated rate for which Commission approval is sought. The report should identify the incremental cost inputs for the model and detail their derivation. The report should also identify any deviations in incremental costs and the reasons therefor. Finally, the report should detail the output of the uniform model and any adjustments made by Piedmont.

The feasibility of modifying Section III.D.3(e) in this manner is supported by cross-examination of Piedmont's Vice President - Regulatory Affairs, Rates and Gas Cost Accounting, Bruce Barkley, who explained that Piedmont utilizes the same cost of service model to determine negotiated rates for all of its contracts, which are also based on the same allowed rate of return on common equity. (Tr. 3 p. 30.) He further explained that incremental costs for materials, labor, land, overhead, AFUDC, taxes, depreciation, O&M expenses, capital structure, and debt will vary from one customer generating unit to another customer generating unit, and the differences in those incremental costs constitute the basis for differing negotiated gas service rates. (Tr. 3 pp. 27-28.) He also characterized the development of negotiated rates as: "a consistent process, but two dissimilar customers would have very dissimilar inputs." (Tr. 3 p. 30.) When asked if Piedmont was going to be "producing a report to explain how all these factors led into the development of a particular rate along with the quantifications that are relevant to the rate, Mr. Barkley explained that Piedmont did not intend to produce such a report 'unless requested to do [so]." (Tr. 3 p 26.)

With the foregoing modifications requested by FPWC, Code of Conduct Section III.D.3(e) would be capable of providing a viable enforcement mechanism

if: (1) Piedmont is required to certify to the Commission whether the uniform model was used to set negotiated rates rather than simply maintain confidential supporting documentation; (2) before any negotiated rate is approved, the Public Staff is required to certify to the Commission that the Public Staff has reviewed the Piedmont report and supporting information and confirmed the use of the uniform model and the same rate of return on common equity and the validity of the incremental cost inputs and their derivation and the output of the model. If Piedmont and the Public Staff publicly file the requisite certifications, then FPWC believes it would be reasonable to impose the burden of proof on a shipper that wishes to challenge a negotiated rate as inconsistent with Section III.D.3(e) or unduly discriminatory pursuant to G.S. 62-140. However, if Piedmont deviates from the use of the uniform model or the derivation of incremental costs or the Public Staff fails to provide the requisite comprehensive certification, then FPWC or another shipper should be entitled to bring an action challenging the proposed negotiated rates as prohibited by the Code of Conduct or G.S. 62-140 in which Piedmont should bear the burden of proving that the negotiated rate is not unduly discriminatory.

WHEREFORE, FPWC requests that the Commission enter an order conditioning its approval of the proposed merger on the imposition of changes to Section III.D.3(e) of the Code of Conduct described above.

Respectfully submitted this the 25th day of August, 2016.

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CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that a copy of the foregoing Brief was served on the parties via hand delivery or email transmitted to their legal counsel of record.

This the 25th day of August, 2016.

WEST LAW OFFICES, P.C.

By: _____
James P. West