STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-2, SUB 1204

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Application of Duke Energy Progress,	)	ORDER ALLOWING RECOVERY
LLC, Pursuant to N.CG.S. § 62-133.2	)	OF LIQUIDATED DAMAGES
and Commission Rule R8-55	)	AND TRANSPORATION COSTS
Regarding Fuel and Fuel-Related	)	
Cost Adjustments for Electric Utilities	)	

HEARD: Tuesday, March 10, 2020, at 10:00 a.m., in Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina

BEFORE: Chair Charlotte A. Mitchell, Presiding; Commissioners ToNola D. Brown-Bland, Lyons Gray, and Daniel G. Clodfelter

APPEARANCES:

For Duke Energy Progress, LLC:

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For the Using and Consuming Public:

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BY THE COMMISSION: On June 11, 2019, Duke Energy Progress, LLC (Duke Energy Progress, DEP, or the Company), filed an application pursuant to N.C. Gen. Stat. § 62-133.2 and Commission Rule R8-55 regarding fuel and fuel-related cost adjustments

for electric utilities, along with the testimony and exhibits of Dana M. Harrington, Brett Phipps, Regis Repko, Kenneth D. Church, and Kelvin Henderson.

Petitions to intervene were filed by the North Carolina Electric Membership Corporation (NCEMC) on June 24, 2019, Fayetteville Public Works Commission (FPWC) on July 1, 2019, Carolina Utility Customers Association, Inc. (CUCA) on July 22, 2019, Sierra Club on August 1, 2019, North Carolina Sustainable Energy Association (NCSEA) on August 9, 2019, and Carolina Industrial Group for Fair Utility Rates II (CIGFUR) on August 19, 2019. The Commission granted NCEMC's and FPWC's petitions to intervene on July 2, 2019, CUCA's petition to intervene on July 24, 2019, NCSEA's petition to intervene on August 13, 2019, Sierra Club's petition to intervene on August 15, 2019, and CIGFUR's petition to intervene on August 20, 2019. The intervention of the Public Staff is recognized pursuant to N.C. Gen. Stat. § 62-15(d) and Commission Rule R1-19(e).

On September 9 and 10, 2019, the Commission held the first hearing in this matter. On November 25, 2019, the Commission issued an Order Approving Interim Fuel Charge Adjustment, Requiring Further Testimony, and Scheduling Hearing (Interim Order). In summary, the Interim Order approved fuel charge adjustments to be implemented by DEP effective December 1, 2019, but withheld for a future decision the question of whether DEP would be allowed to recover from ratepayers the actual damages and liquidated damages being paid by DEP to CertainTeed Gypsum NC, Inc. (CTG), based on a judgment for breach of contract entered against DEP in the North Carolina Business Court. The Interim Order required the Public Staff to file supplemental direct testimony and DEP to file supplemental rebuttal testimony on the CTG issue, and scheduled a hearing on the issue to be held on March 10, 2020.

On January 17, 2020, the Public Staff filed supplemental direct testimony and exhibits of Jay B. Lucas.

On February 17, 2020, DEP filed joint supplemental rebuttal testimony and exhibits of Barbara Coppola and John Halm, and supplemental rebuttal testimony of John Gaynor.

On March 10, 2020, the case came on for hearing as scheduled.

On April 20, 2020, the Public Staff filed its Proposed Findings of Fact and Conclusions of Law.

Also on April 20, 2020, DEP filed a Post-Hearing Brief.

On May 28, 2020, the Commission issued an Order Requiring Filing of Post-Hearing Exhibit directing DEP to file with the Commission on or before June 3, 2020, an affidavit that was filed by witness Halm in the North Carolina Business Court. On June 1, 2020, DEP filed witness Halm's affidavit.

The Commission incorporates herein by reference the findings of fact and conclusions of the Interim Order. For purposes of clarity, the findings of fact pertaining to the CTG issue are set forth below.

7. Gypsum is a by-product produced in the electric generation process and the input leading to gypsum is coal.

8. The Company entered a long-term agreement to sell gypsum to BPB NC, Inc. (BPB) in 2004. CertainTeed Gypsum NC, Inc. (CTG) is the successor-in-interest to BPB.

9. Under the agreement, CTG was obligated to construct a wallboard manufacturing facility adjacent to DEP's Roxboro coal-fired generation plant and committed to purchase substantial amounts of gypsum from the Roxboro and Mayo plants (Roxboro units).

10. The initial agreement included a liquidated damages provision. The initial agreement was amended on a number of occasions—ultimately resulting in the Second Amended and Restated Supply Agreement—but the liquidated damages provision was an essential part of the agreement and remained substantially unchanged from the initial agreement through to the Second Amended and Restated Supply Agreement (Gypsum Supply Agreement).

11. In light of CTG's substantial capital investment in its wallboard manufacturing facility adjacent to the Roxboro plant, one purpose of the liquidated damages provision was to provide CTG with certainty regarding the damages it would be entitled to recover in the event that DEP was unable to supply the full amount of gypsum required under the Gypsum Supply Agreement.

12. The evidence tends to show that the amount of gypsum produced by the Roxboro units substantially declined due to lower natural gas prices that decreased DEP’s use of coal-fired generation, and several other factors.

13. As a result of the decrease in generation by the Roxboro units, the Company was unable to meet the monthly minimum delivery obligations under the Gypsum Supply Agreement.

14. In litigation filed by CTG against DEP in the North Carolina Business Court (Court) for breach of the Gypsum Supply Agreement, the Court entered a Judgment finding DEP liable for breach of the contract. The Court ordered DEP to pay actual damages to CTG for gypsum not delivered, and to meet its future contract obligations.

15. In light of the options available to the Company under the Gypsum Supply Agreement and the Court's Judgment, the Company discontinued supply under the Gypsum Supply Agreement, after providing some gypsum for a limited period of time and

in limited amounts under a replacement agreement, and paid CTG liquidated damages rather than delivering replacement gypsum.

16. The actual damages and liquidated damages paid and to be paid by DEP under the Gypsum Supply Agreement are part and parcel of the sale of gypsum that was agreed upon by DEP and CTG in the Gypsum Supply Agreement.

17. If DEP's decisions and actions in connection with the Gypsum Supply Agreement with CTG were reasonable and prudent, then DEP's payments of liquidated damages to CTG can be recovered as fuel-related costs pursuant to N.C.G.S. § 62-133.2(a1)(9).

18. The evidence of record is insufficient to enable the Commission to determine whether DEP's decisions and actions in connection with the Gypsum Supply Agreement with CTG were prudent and reasonable. As a result, it is appropriate for the Commission to receive additional evidence and hold a further hearing on the issue of whether DEP's decisions and actions in connection with the Gypsum Supply Agreement with CTG were prudent and reasonable.

Based on the Interim Order, the evidence presented at the March 10, 2020 hearing, and the record as a whole, the Commission makes the following:

ADDITIONAL FINDINGS OF FACT

Background

1. When CTG and DEP entered into the initial gypsum supply agreement in 2004 (2004 Agreement), DEP was planning to install flue gas desulfurization systems (scrubbers) that would produce synthetic gypsum at its Roxboro and Mayo coal-fired plants (Roxboro Plants), and CTG was planning to build its first wallboard manufacturing plant in the southeast United States.

2. The 2004 Agreement defined the monthly minimum quantity (MMQ) of gypsum that DEP would deliver and CTG would accept as 50,000 net dry tons of gypsum (Fixed MMQ). The Fixed MMQ level was based on what DEP was willing to provide over the life of the agreement.

3. DEP did not deliver gypsum to CTG and CTG did not accept gypsum under the 2004 Agreement, primarily due to the decline in the housing market that resulted from the 2008 economic downturn.

4. In 2008 the parties executed an amended agreement (2008 Agreement) following CTG's decision to delay construction of its plant because of the 2008 economic downturn. Under the 2008 Agreement, CTG was required to accept and DEP was required to deliver the Fixed MMQ of 50,000 net dry tons of gypsum.

5. The Roxboro Plant scrubbers began coming on-line in spring 2007. Every six months an additional scrubber came on line at each of the five units at Roxboro and Mayo, with the final scrubber coming on line in the spring of 2009.

Negotiations Leading to the 2012 Agreement

6. Between June 2011 and February 2012, DEP witness Coppola and CTG employee Dave Engelhardt, Senior Vice President of Operations, negotiated a revised contract that replaced the 2008 Agreement (2012 Agreement).

7. In 2011 there were several facts that caused CTG to want to renegotiate the 2008 Agreement, including:

(a) CTG had accepted no gypsum from DEP from execution of the 2004 Agreement until May 2009;

(b) The Great Recession of 2008 had demonstrated to CTG its vulnerability to a downturn in the housing market;

(c) CTG had experienced delays in construction of its manufacturing plant, with commercial operation not anticipated until approximately October 2012;

(d) During the period of 2008 to 2012, CTG accepted gypsum in the amount equal to or above the Fixed MMQ in only six months; and

(e) CTG had paid $32 million to dispose of gypsum received under the 2008 Agreement in a landfill because it was unable to use it.

The above factors did not, however, change CTG's intent to retain the supply certainty that it had obtained and was in effect in the 2008 Agreement, particularly in light of the fact that CTG's plant was completed in March 2012 and production ramped up from that point in time.

CTG Redline and 2012 Agreement

9. In October 2011 Engelhardt sent DEP witness Coppola a possible revised contract as a redlined draft agreement (CTG Redline).

10. The CTG Redline that Engelhardt sent to Coppola proposed several changes to the terms of the 2008 Agreement, chief of which was to shift from a monthly focus to an annual minimum quantity requirement, with any default to be measured against the annual quantity. Further, under the CTG Redline, CTG would be obligated to accept DEP's actual production of gypsum or 600,000 net dry tons, whichever was less, and whatever amount of gypsum was necessary to guarantee that the stockpile did not exceed 600,000 net dry tons. In turn, DEP would be required to maintain at least 100,000

net dry tons of gypsum in the stockpile at all times, irrespective of what DEP actually produced at Roxboro or Mayo.

11. DEC rejected the revisions proposed in the CTG Redline.

12. DEP and CTG executed the 2012 Agreement with an effective date of August 1, 2012. The 2012 Agreement required a Fixed MMQ of 50,000 net dry tons of gypsum per month, a minimum stockpile level of 250,000 net dry tons, and was effective through April 2029. The effect of the quantity terms in the 2012 Agreement was to require DEP to deliver a minimum annual quantity of 600,000 tons, just as the CTG Redline had proposed, albeit expressed in terms of a minimum monthly quantity over the course of each year.

13. Under the 2012 Agreement, as under the 2008 Agreement, CTG had the right to terminate the contract and collect liquidated damages from DEP if DEP failed to supply 50% of the 50,000 MMQ each month over a five year period or delivered less than 300,000 tons of gypsum per year in two consecutive years.

Prudency Review and Alternatives

14. In 2011 DEP had substantial information about the potential effects of lower natural gas prices, the JDA, and DEP's conversion to natural gas-fired generation on DEP's ability to supply CTG with 50,000 tons of gypsum a month from August 2012 through April 2029.

15. Based on the reasonably foreseeable effects of lower natural gas prices, the JDA, and DEP's conversion to natural gas-fired generation on DEP's ability to supply CTG with 50,000 tons of gypsum a month from August 2012 through April 2029, it would have been reasonable for DEP to further explore with CTG revising its delivery obligations prior to signing the 2012 Agreement.

16. Notwithstanding DEP's failure to explore other options with CTG, there was no reasonable likelihood that CTG would relinquish the supply certainty that it had secured in the 2004 and the 2008 Agreements.

17. If DEP had accepted the approach set forth in the CTG Redline it is reasonably likely that by 2018 or 2019 it would have had difficulty providing to CTG at least 300,000 tons of gypsum annually and would have been unable to both deliver a minimum of 300,000 tons of gypsum annually and also maintain a minimum stockpile at all times not less than 100,000 tons.

18. After entry of the Business Court Judgment it was reasonable and prudent for DEP to agree to pay CTG the contract damages ordered by the court and to exercise its right to terminate the 2012 Agreement and pay liquidated damages to CTG in consequence of such termination.

19. DEP is entitled to recover in its fuel rider the North Carolina retail portion of both the contract damages awarded by the Business Court and the liquidated damages resulting from DEP's subsequent termination of the 2012 Agreement.

EVIDENCE AND CONLUSIONS FOR FINDINGS OF FACT NOS. 1-5

The evidence supporting these findings and conclusions is contained in the direct and supplemental testimony and exhibits of Public Staff witness Lucas, the joint rebuttal and supplemental rebuttal testimony of DEP witnesses Coppola and Halm (collectively, DEP Panel), the Opinion and Final Judgment (Judgment) in the lawsuit between CTG and DEP, *CertainTeed Gypsum NC, Inc. v. Duke Energy Progress, LLC*, 17 CVS 395 (Person County), 2018 NCBC 90 (*CTG v. DEP*), introduced into the record as Fayetteville Public Works Commission (FPWC) Harrington Cross-Exam Exhibit 3.

With respect to the Business Court's Judgment, the Commission does not rely on the court's findings of fact or conclusions in this Order. The Business Court's main inquiry was the intent of DEP and CTG in entering into the 2012 Agreement, and, specifically, whether they intended the 2012 Agreement to be a fixed quantity or a variable quantity supply contract. Based on extensive testimony, including testimony by Engelhardt, who did not testify before the Commission, the court concluded that the parties intended for the 2012 Agreement to require DEP to supply to CTG the Fixed MMQ of 50,000 tons per month. The Commission accepts that conclusion, but finds it only tangentially related to the Commission's main inquiry – whether DEP acted in a reasonable and prudent manner in entering into the 2012 Agreement in light of the changes in DEP's use of coal-fired generation and the alternatives available to DEP at the time. Therefore, the Commission determines that it is appropriate for the Commission to cite the Business Court's findings of fact where such findings provide useful, uncontroverted background information and where the Commission's findings of fact are corroborated by the court's findings.

Summary of the Evidence

In his supplemental testimony Public Staff witness Lucas testified that CTG and DEP first entered into a gypsum supply agreement in 2004. At that time, DEP was planning to install flue gas desulfurization systems (scrubbers) that would produce synthetic gypsum at its Roxboro and Mayo coal-fired plants, and CTG was seeking to build its first wallboard-manufacturing plant in the southeast United States. Tr. Vol. 3, 16. Witness Lucas testified that gypsum is a mineral that is the primary component of gypsum wallboard. It can be mined in its natural state but synthetic gypsum is a suitable substitute and is a by-product of the flue gas desulfurization (FGD) equipment installed at some coal-fired plants, including DEP's Roxboro and Mayo coal-fired power plants (Roxboro Plants). Tr. Vol 2, 60-61. He stated that the Roxboro plant consists of four generating units with a total capacity of 2,462 MW (winter rating), and the Mayo plant has one generating unit with a capacity of 746 MW (winter rating), and that both of these plants are located in Person County, approximately 16 road miles apart. Id. Witness Lucas testified that during the Business Court trial DEP witness Coppola testified that the scrubbers began coming on-line in spring 2007 at Roxboro; and that every six months

an additional scrubber came on line at each of the five units at Roxboro and Mayo, with the final scrubber coming on line in the spring of 2009. Tr. Vol. 3, 17.

Witness Lucas testified that in order to mitigate the cost of disposing of the gypsum produced in the FGD process, in 2004 DEP executed a contract with CTG's parent company for the future sale of artificial gypsum from the Roxboro Plants to CTG for the manufacture of gypsum board. Witness Lucas stated that in 2005 CTG acquired approximately 121 acres of land from DEP adjacent to the Roxboro plant with the intent of constructing a gypsum wallboard manufacturing facility. According to witness Lucas, CTG delayed construction of the wallboard manufacturing facility due to the housing market decline and economic downturn (Great Recession), and in late 2007 CTG contacted DEP in an effort to amend the 2004 Agreement and maintain the supply of artificial gypsum in the future. *Id.* at 61-62.

Witness Lucas testified that in 2008 DEP and CTG executed an Amended and Restated Supply Agreement that made refinements to the 2004 contract. Thereafter, beginning May 1, 2009, CTG began accepting artificial gypsum from DEP but transported it to other locations because the CTG facility adjacent to the Roxboro plant had not yet been completed. According to witness Lucas, the CTG facility at the Roxboro plant began operation on March 28, 2012. *Id.* at 62.

Witnesses Coppola and Halm testified that CTG was investing approximately $200 million to construct a wallboard production facility that was projected to operate for approximately 20-30 years, which required an assurance of a supply of gypsum sufficient to justify construction. Witnesses Coppola and Halm asserted that no rational investor would have been willing to make such a substantial investment without having an assurance of a cost-effective supply of gypsum that would be necessary to sustain operations. Tr. Vol. 3, 168.

Witnesses Coppola and Halm testified that in 2008 the parties executed an amended agreement (2008 Agreement) following CTG's decision to delay construction of its plant because of the 2008 economic downturn. *Id*. at 166. They further testified that from the very beginning of the transaction a minimum monthly delivery and acceptance obligation was included. Specifically, the 2004 Agreement contained a Minimum Monthly Quantity (Fixed MMQ) delivery and acceptance obligation of 50,000 tons, subject to 10% variation, which effectively resulted in an annual delivery and acceptance obligation of 600,000 tons per year. The DEP Panel testified that these obligations were carried forward into the 2008 Agreement. *Id.* at 167-68.

Conclusion

The Commission agrees with DEP witnesses Coppola and Halm and concludes that in 2004 and 2008, given the level of CTG's planned investment in the wallboard facility at Roxboro, CTG was pursuing a fixed monthly amount of gypsum for its future wallboard facility in order to obtain supply certainty.

EVIDENCE AND CONLUSIONS FOR FINDINGS OF FACT NOS. 6-8

The evidence supporting these findings of fact and conclusions is contained in the direct and supplemental testimony of Public Staff witness Lucas, the rebuttal and supplemental rebuttal testimony of Company witnesses Coppola and Halm, and the rebuttal testimony of Company witness John Gaynor.

Summary of the Evidence

Public Staff witness Lucas described the negotiation and execution of the 2012 Agreement in his supplemental testimony. According to witness Lucas, CTG's Dave Engelhardt testified during the Business Court trial that after 2008 CTG changed the design of its plants, specifically the feeding system, and needed to update the agreement to account for those changes. Witness Lucas testified that having observed the way CTG and DEP operated over the previous couple of years, Engelhardt had some thoughts on how to try to make the agreement more usable and build in some flexibility to cover variations. He had observed that production volumes on DEP's side varied and that CTG's demand for gypsum varied with the market for wallboard. Tr. Vol. 3, 17-18. Witness Lucas testified that Lucas Supplemental Exhibit 1 reflects the actual production volumes for Roxboro and Mayo for 2008-2012, and confirms that production volumes did in fact vary. In addition, DEP witness Halm testified that there were only about six months between 2008 and 2012 that CTG accepted the full Fixed MMQ of 50,000 tons. Tr. Vol. 3, 203.

During the hearing witness Lucas testified that after execution of the 2008 Agreement CTG realized it was not going to be able to meet its commitment to DEP to take the Fixed MMQ of gypsum. As examples of this realization, witness Lucas testified that CTG had accepted no gypsum from DEP under the 2004 Agreement, and that between 2008 and 2012 CTG had paid approximately $32 million to dispose of gypsum it could not use in its plant. Witness Halm corroborated this, testifying that in January 2010 CTG disposed of 80,000 tons of gypsum in a landfill in order to get it off the DEP stockpile because the stockpile was more than full, and the gypsum had to be removed for environmental and safety reasons. Tr. Vol. 3, 204. Thus, according to witness Lucas, between the 2008 and 2012 Agreement CTG had reasons to be cautious because it needed to maintain a balance between a minimum amount and a maximum amount of gypsum. Witness Lucas testified that it appeared that in October of 2011, once CTG was getting closer and closer to actually building a facility, that CTG realized it might not want 50,000 tons of gypsum per month. *Id.* at 53-55. However, he also agreed that the CTG facility at Roxboro did need a certain amount of gypsum to stay in business. *Id.* at 41, 47.

Witnesses Coppola and Halm testified that given that CTG already had certainty of supply under the 2008 Agreement, there was no reasonable scenario in which CTG would voluntarily waive its pre-existing minimum delivery rights and risk not being able to fully leverage its investment, particularly in light of the fact that there were no other economically viable sources of gypsum for CTG's Roxboro wallboard facility. They contended that this is supported by the conclusion of the Business Court that while CTG

was willing to offer some monthly flexibility, it never intended to change the MMQ from the fixed volume of 50,000 net dry tons per month to a variable MMQ based on DEP's actual production at Roxboro and Mayo. Tr. Vol. 3, 179.

John Gaynor, a former employee of United States Gypsum (USG), testified that in his positions with USG he was responsible for procuring synthetic gypsum for USG and oversaw the procurement process, including contractual terms. His work also included developing new supply sources and agreements with power companies in connection with the development of three new greenfield wallboard plants. He stated that he reviewed the testimony of Public Staff witness Lucas, portions of the 2004 Agreement, the 2008 Agreement, and the 2012 Agreement. He also reviewed the CTG Redline (Coppola and Halm Supplemental Exhibit 1), and the Judgment. He concluded:

> 1. The flexibility offered by CTG in the context of the negotiations of the 2012 Agreement would not have excused DEP from satisfying the annual delivery obligation that was already in effect and would potentially have imposed an absolute minimum stockpile obligation.
>
> 2. The financial viability of the CTG manufacturing facility at Roxboro would have been highly dependent on an adequate supply of gypsum.

According to witness Gaynor, it is, therefore, reasonable and consistent with industry practice in similar situations that CTG would have obtained supply certainty from DEP in order to ensure that CTG could maximize production at its facility. Witness Gaynor further testified that once CTG had obtained supply certainty, as it did under the 2004 Agreement, and actually constructed the wallboard facility, he did not believe that CTG would have proposed or accepted any contract modification that would have materially reduced its long-term certainty of supply. Tr. Vol. 3, 254-255.

DISCUSSION AND CONCLUSION

The Commission gives substantial weight to witness Gaynor's testimony, based largely on his experience and expertise in the wallboard manufacturing industry. Further, the Commission agrees with his premise that the CTG manufacturing plant would be highly dependent on an adequate supply of gypsum, and that it is consistent with industry practice to obtain a regular and dependable supply of gypsum.

In its Post-Hearing Brief DEP contended that because of CTG's investment in the Roxboro wallboard plant and other commercial considerations, as discussed by witness Gaynor, CTG would not have considered any contract changes that would eliminate a requirement that DEP deliver at least 600,000 tons, measured annually, of gypsum. DEP Brief, at 17-18. According to DEP the basic premise of the 2011-2012 negotiations was that DEP would be unable to modify the annual minimum quantity requirement, even if it had been possible to negotiate some flexibility with respect to quantities delivered from month-to-month. The Commission accepts that premise, and concludes that it is not

reasonably likely that CTG would have voluntarily relinquished the supply certainty that induced its original investment in the facility.

The Commission also gives weight to the particular facts of CTG's situation, which led to CTG's desire to negotiate in the 2011-2012 timeframe. Those facts included:

(1) Having entered into the 2004 Agreement and a plan to build a wallboard plant at the Roxboro site, by 2008 CTG had accepted no gypsum from DEP, and its plant was not built. As a result, CTG and DEP negotiated a new contract, the 2008 Agreement;

(2) While working on its $200 million investment in the Roxboro plant, between 2008 and 2012 CTG paid approximately $32 million to dispose of gypsum it could not accept;

(3) The Great Recession of 2008 had demonstrated to CTG its vulnerability to a downturn in the housing market;

(4) In 2011, CTG's Roxboro plant was still not completed; and

(5) In 2011, CTG, for the second time in seven years, sought to renegotiate its contract with DEP.

Nonetheless, the above facts do not outweigh the fact that CTG invested $200 million in its wallboard manufacturing facility adjacent to DEP's Roxboro plant, an investment that was predicated on the 2004 and 2008 Agreements that provided CTG an assured supply of gypsum from DEP.

Based on the foregoing, the Commission finds and concludes that CTG had a reasonable business basis to maintain its entitlement under the 2004 and the 2008 Agreements to supply certainty. As a result, the starting point under which DEP and CTG were negotiating in 2011 was that CTG would require that same degree of supply certainty- 50,000 MMQ or a corresponding annual equivalent of 600,000 tons.

EVIDENCE AND CONLUSIONS FOR FINDINGS OF FACT NOS. 9-17

The evidence supporting these findings of fact and conclusions is contained in the Commission's dockets for the merger of Duke Energy Corporation and Progress Energy, Inc., Docket Nos. E-2, Sub 998 and E-7, Sub 986, the direct and supplemental testimony of Public Staff witness Lucas, the rebuttal and supplemental rebuttal testimony of Company witnesses Coppola and Halm, and the testimony of Engelhardt during the Business Court trial.

Summary of the Evidence

The DEP Panel and Public Staff witness Lucas testified to the negotiations between DEP and CTG from October 2011 through February 2012 on modifications to the 2008 Agreement. Public Staff witness Lucas testified that Engelhardt provided a list of proposed modifications to the 2008 Agreement entitled "Roxboro Stockpile Scenarios" (Roxboro Scenarios) to DEP witness Coppola. The Roxboro Scenarios were attached to witness Lucas' testimony as Confidential Lucas Supplemental Exhibit 2. The same document was entered into evidence during the Business Court trial as Exhibit 24. Witness Lucas testified that Engelhardt discussed the Roxboro Scenarios with witness Coppola. Tr. Vol. 3, 18; DEP Lucas Cross Examination Exhibit 4, p. 236 [Trial Transcript, Vol. 2].

During the Business Court trial Engelhardt stated that he was thinking about flexibility for CTG in the amount of gypsum that it had to accept and flexibility for DEP in the amount of gypsum that it had to supply when he prepared the Roxboro Scenarios. Trial Tr., Vol. 2, 136-37. According to Engelhardt, he tried to include the concepts of the Roxboro Scenarios in a draft redlined agreement (CTG Redline) that he sent to Company witness Coppola in October 2011. The CTG Redline was introduced into evidence in the Business Court as Exhibit 23, and before the Commission as DEP Supplemental Exhibit 1. The following is the exchange between Engelhardt and CTG's counsel regarding the timing of the Roxboro Scenarios and CTG Redline, and Engelhardt's testimony as to witness Coppola's response to them.

> Q. All right. So you sent Exhibit 23 [CTG Redline] to Ms. Coppola in October of 2011, correct?
>
> A. That's correct.
>
> Q. And what happened after that?
>
> A. Well, we -- I had sent her the scenarios as well. And we had a call -- I don't remember exactly -- maybe a week later, to discuss the scenarios page that I had sent her. And from then, there wasn't a lot of activity going back and forth. They were reviewing the contract. Barbara did tell me when we reviewed the scenarios that she preferred to stay with the contract -- the minimum monthly requirements and those numbers as they were stated in the 2008 agreement.
>
> Q. Take a look, if you would, at Exhibit 25, please, Mr. Engelhardt.
>
> A. Okay.
>
> Q. And are you familiar with this document?
>
> A. Yes.

Q. And is this a series of emails between you and Ms. Coppola?

A. Yes, it is

Q. And in the email -- there's an email -- the first email at the bottom of the page is dated October 24, 2011. Do you see that?

A. That's correct

Q. That's 2 weeks after you sent her -

A. Yes.

Q. -- your draft; is that right?

A. That's correct

Q. And does she make a statement in this agreement about what Duke would like to do with regard to the volumes?

A. Yes. She said: “In general, we would like to leave the volume obligation as is. We can discuss."

Q. All right. When did Duke respond to your October 2011 draft?

A. They sent a draft back in February of 2012.

Q. And after you had a conversation with Ms. Coppola in October about your scenarios, can you describe the level and nature of communication between Duke and CTG about this contract?

A. There really wasn't any -- any significant communications. We really never sat down and discussed any further -- after the scenarios discussion, we didn't really discuss anything further. There might have been one or two phone calls in there on "where are you, " "where do we stand on this, " but that would have been the extent of it.

Lucas Exhibit 4, pp. 157-59.

The October 24, 2011 email from witness Coppola that Engelhardt referenced was attached to witness Lucas’ supplemental direct testimony as Confidential Lucas Supplemental Exhibit 3.

In response to questions from the Commission during the March 10, 2020 hearing, witness Coppola stated that she remembered receiving the Roxboro Scenarios and CTG Redline from Engelhardt in October 2011, and that there were numerous discussions

around building some flexibility into the contract. Tr. Vol. 3, 210-12. However, in their supplemental rebuttal testimony Company witnesses Coppola and Halm asserted that in assessing whether it were imprudent for DEP to reject the majority of the changes proposed in the CTG Redline, it is necessary to understand the precise details of what CTG actually offered and to assess whether what CTG offered was better than what was already in effect. They explained that the delivery and acceptance obligations of the parties were measured in three distinct but related ways: (1) monthly delivery and acceptance quantifies, (2) annual delivery and acceptance quantities, and (3) minimum and maximum stockpile quantities. Tr. Vol. 3, 174.

Witnesses Coppola and Halm provided CTG's Redline changes as DEP Supplemental Exhibit 1 (introduced in the Business Court as Exhibit 23). According to witnesses Coppola and Halm, the modifications proposed by CTG were intended only to provide greater monthly variability but left in place the 600,000-ton annual quantity obligation and introduced new obligations related to DEP's obligation to maintain a minimum stockpile. They cited Finding of Fact No. 111 of the Judgment in which the Business Court concluded that CTG intended to allow for greater monthly variations while maintaining an annual quantity obligation and requiring a stockpile buffer. They opined that the reason CTG may have been interested in obtaining more flexibility with respect to the monthly delivery and acceptance obligations is that during the time period in which CTG's operations were ramping up, CTG was typically unable to accept enough gypsum to satisfy the MMQ. According to the DEP Panel, due to its contractual acceptance obligations CTG incurred more than $32 million disposing of gypsum that it was not able to receive and utilize at its facility. *Id.* at 174-75.

Witnesses Coppola and Halm stated that the CTG Redline proposed that DEP be obligated to maintain the stockpile at a minimum of 100,000 tons. They asserted that it would have been imprudent of the Company to accept CTG's proposed revisions because the proposal did not offer DEP significant advantages over the existing agreement – that is, it left in place a 600,000-ton annual delivery obligation and may have imposed obligations related to the stockpile that were potentially more onerous than those under the 2008 Agreement. Further, according to witnesses Coppola and Halm, even if DEP had accepted the CTG Redline exactly as proposed, DEP would still be in the exact same situation as it is today, and DEP would have been unable to satisfy the annual delivery requirements or maintain the minimum stockpile amounts without incurring substantial additional costs to obtain gypsum from sources other than the Roxboro and Mayo plants.. Further, they opined that DEP would still have had to exercise the right to discontinue supply and pay liquidated damages. *Id.* at 176-77.

Regarding the Roxboro Scenarios presented by the Public Staff as Lucas Confidential Supplemental Exhibit 2, witnesses Coppola and Halm contended that the Roxboro Scenarios represented an earlier iteration of CTG's perspective on possibilities related to delivery obligations. Witnesses Coppola and Halm asserted that like the CTG Redline the Roxboro Scenarios would have introduced a level of short-term flexibility while imposing firm obligations that were either the same or more onerous than was currently in effect under the 2008 Agreement. *Id.* at 177-78.

The 2012 Agreement was executed with an effective date of August 1, 2012. Tr. Vol. 3, 18-19. The 2012 Agreement was entered into evidence as Confidential FPWC Harrington Exhibit 1.[1]

In its Interim Order the Commission took note of the dates of several events described by witness Lucas in relation to the date that DEP entered into the 2012 Agreement. One such date was April 4, 2011, when Duke Energy Corporation and Progress Energy, Inc. filed the application for approval of their merger in Docket Nos. E-2, Sub 998 and E-7, Sub 986 (merger proceeding). The Commission further noted that attached to the merger application was a Joint Dispatch Agreement (JDA) (Exhibit 3), and that on June 29, 2012, the Commission issued its Order Approving Merger Subject to Regulatory Conditions and Code of Conduct (Merger Order). The Commission further observes that DEP employee Alexander Weintraub, who signed the 2012 Agreement, filed direct testimony on behalf of DEP on May 20, 2011, in the merger proceeding, and filed supplemental testimony on June 13, 2012.

In his direct testimony Public Staff witness Lucas stated that under the JDA, which the companies entered into after the merger was approved, energy purchases between DEP and DEC are facilitated, thereby enabling the two companies to optimize the efficient dispatch of their combined generating fleets. Tr. Vol. 2, 63.

Also attached to the merger application, as Exhibit 4, was a Compass Lexecon Analysis of Economic Efficiencies Under Joint Dispatch (Compass Lexecon Study). The Compass Lexecon Study was introduced at the hearing as Public Staff Lucas Redirect Exhibit 3. Witness Lucas testified that the Compass Lexecon Study, and in particular Exhibit 1 to the Study, showed that beginning in 2012, assuming the merger was approved, the utilization of DEC's large coal-fired generating units would increase across the majority of months, while the utilization of DEP's large coal-fired generating units would decrease across the majority of months. Witness Lucas stated that the Study further found that during hours when DEC's high efficiency coal-fired generators have excess production capability they can provide lower cost energy compared to DEP's somewhat less efficient large coal-fired generators, such as Roxboro and Mayo.

In his supplemental testimony, witness Lucas noted that Ordering Paragraph No. 3 in the Commission's Merger Order issued on June 29, 2012, approved the JDA and that the Merger Order was issued more than one month before the effective date of the 2012 Agreement, August 1, 2012. Tr. Vol. 3, 26. Further, the Commission notes that on July 2, 2012, Duke Energy and Progress Energy filed a letter in the merger proceeding notifying the Commission that they accepted all of the terms and conditions of the Merger Order.

In their supplemental rebuttal testimony, witnesses Coppola and Halm asserted that negotiations regarding the 2012 Agreement commenced in June 2011, well before there was any degree of certainty regarding the outcome of the merger and before

[1] By letter dated April 20, 2020, the Public Staff informed the Commission that the Company agreed that the confidential designation for this document should be removed.

important aspects of the JDA were solidified. They further testified that the parties had largely resolved the major commercial terms of the 2012 Agreement by February 2012, well before there would have been certainty regarding the merger or the ultimate impact of the JDA. Tr. Vol. 3, 184. Further, witnesses Coppola and Halm stated that they had been advised that it was not possible to have finalized the JDA prior to the Commission's approval of the merger. They stated that DEP merger witness Weintraub stated in his initial testimony in the merger proceeding that DEC and DEP could not share proprietary information prior to approval of the merger. They also asserted that while the Compass Lexecon Study projected total savings from the JDA over a five-year period, it also described the complexity of the JDA and that many issues other than fuel costs had to be considered. Witnesses Coppola and Halm testified that many of these issues could not be resolved until the merger was approved and proprietary information could be shared and analyzed. Tr. Vol. 3, 184-185.

Finally, witnesses Coppola and Halm testified that the JDA did not reduce the amount of generation at Mayo and Roxboro; rather, the primary cause of the reduced generation was lower gas prices. They noted that during the Business Court trial DEP witness Eric Grant testified that the JDA had not caused the reduction in dispatch from Roxboro and Mayo, that Grant testified that 80% of the megawatt hours had flowed from DEP to DEC under the JDA, and that the court rejected the position that the JDA caused a reduction in DEP's production of synthetic gypsum. *Id.* at 186.

Public Staff witness Lucas testified as to what the Company's 2010 and 2012 avoided cost data showed regarding DEP's planned dispatch of coal-fired units. He testified that in DEP's responses to data requests in the 2010 and 2012 Avoided Cost proceedings, the latter being more than two months before DEP signed the 2012 Agreement on August 1, 2012,[2] DEP stated that it anticipated that dispatch of its coal plants would play a lesser role going forward in meeting energy requirements. According to witness Lucas, this evidences that DEP knew that less frequent dispatch of its coal plants would mean reduced gypsum production, and that DEP should have taken that information into account when negotiating and signing the 2012 Agreement. *Id.* at 22-23.

Further, Public Staff witness Lucas testified in detail about DEP's and DEC's extensive pre-2011 efforts at converting from generating electricity with coal to generating with natural gas. Witness Lucas opined that this evidence shows that well before negotiating and executing the 2012 Agreement DEP was aware that it was retiring coal-fired units and replacing them with natural gas-fired generation. Tr. Vol. 3, 28-29.

Public Staff witness Lucas also testified regarding DEP's gypsum forecasts. He stated that in a forecast performed on December 15, 2011, attached to his testimony as Lucas Supplemental Exhibit 4, DEP was not forecasting production of more than 50,000 dry tons of gypsum per month from Roxboro and Mayo for any month in 2012. Witness Lucas also attached to his testimony Lucas Supplemental Exhibit 5, which was a gypsum

[2] According to witness Lucas, presumably DEP ran the models that produced these numbers well in advance of filing its 2012 Avoided Cost data.

forecast that DEP provided to CTG on May 23, 2012, more than two months before DEP executed the 2012 Agreement. According to witness Lucas, the document shows that as of May 2012 DEP was not forecasting 50,000 tons of gypsum a month from Roxboro and May through the end of 2013. *Id.* at 29.

In addition to the gypsum forecasts, witness Lucas provided evidence of the actual production of gypsum at Roxboro and Mayo leading up to the execution of the 2012 Agreement. Attached to his testimony as Lucas Supplemental Exhibit 1 was a table which showed that for 2008, 2009, 2010, and 2011, the highest annual production at both plants combined averaged 37,748 wet tons per month (2010), which he testified equates to about 35,280 dry tons per month. According to witness Lucas, in 2012 the two plants averaged 51,023 wet tons per month, which equates to 47,686 dry tons per month at a 93.46% wet-to-dry reduction. Witness Lucas asserted that the gypsum forecasts and actual production history demonstrate that in 2012 DEP knew or should have known that it was not producing and was not expected to produce 50,000 net dry tons of gypsum a month at Roxboro and Mayo. *Id.* at 29-30.

During the hearing, witness Lucas testified that DEP overcommitted in the 2012 Agreement. He asserted that DEP had plenty of information on hand to cause it to realize that it was not going to be able to meet the 50,000-ton MMQ. According to witness Lucas, this included the fact that in the three years prior to 2012 the Roxboro and Mayo Plants had not come close to making 50,000 tons of gypsum per month, and that in the 2010 avoided cost proceeding DEP predicted that coal-fired plants would be dispatched less frequently going forward. Witness Lucas further cited DEP's 2010 prediction that its 2011 coal dispatch would be about 92% less than in 2010, and its prediction of reduced dispatch until about 2017, when coal dispatch would go down to 63% of DEP's 2010 level. Witness Lucas also testified that around 2009 natural gas prices had plummeted, and that they were still low in 2012. He stated that DEP had two natural gas-fired high efficiency plants under construction at the time that could have displaced Roxboro and Mayo's generation. Tr. Vol. 3, 22, 45-46.

Witness Lucas further asserted that DEP had every reason to believe it could never meet the 50,000 tons, and every reason to at least examine the option of not committing itself to supply 50,000 tons of gypsum to CTG per month. He testified that he did not know if DEP would have ended up in the same place had they accepted CTG's proposed revisions, but that it would have been less likely. *Id.* at 70-71. Witness Lucas testified that he had not performed any analysis or examination to determine whether or not DEP would have been able to avoid a breach of the provisions of the CTG Redline had it accepted those provisions and reduced them to a final executed agreement. Tr. Vol. 3, 131-135.

Company witnesses Coppola and Halm acknowledged in their supplemental rebuttal testimony that generation from DEP's coal-fired plants was generally declining over the period 2010-2012. They also acknowledged that the Company was retiring some of its smaller, less efficient coal-generating units during that time frame. They asserted, however, that it is a leap of tremendous proportion to conclude from these facts that the Company had sufficient information to definitively conclude that it would be unable to

satisfy its gypsum supply obligation over a 17-year period. They contended that it was not accurate to assume that gypsum production bears a linear relationship to capacity factors, and there are many factors that influence actual gypsum production. They stated that coal with a 3% sulfur content (e.g. Illinois Basin coal) will produce three times as much gypsum as 1% sulfur content (e.g. Central Appalachian coal) for the same volume of coal burn with similar heat content. Similarly, they testified that limestone purity and sulfur dioxide (SO_2) removal efficiency can have a material impact on the amount of synthetic gypsum produced from a coal-fired unit independent of the unit's capacity factor. They stated that during the time period in which the parties were negotiating the 2012 Agreement DEP was performing testing of various combinations of Illinois Basin coal at Roxboro and Mayo and that use of that lower cost, higher sulfur coal would, all things being equal, increase the amount of gypsum being produced even at a reduced level of generation. Tr. Vol 3, 182-183.

With respect to the Company's gypsum forecasts presented by witness Lucas, while agreeing that the two forecasts projected gypsum production levels lower than the Fixed MMQ over a short-term period, witnesses Coppola and Halm stated that two factors should be taken into account. First, during the 2011-2012 time period, the gypsum stockpile was near the maximum capacity and therefore, there was no scenario where DEP would be deemed to have failed to provide the MMQ in the short term, even if the actual gypsum production from Roxboro and Mayo was less than 50,000 tons per month. Therefore, they asserted that the fact that the short-term forecasts show monthly production less than 50,000 tons does not mean that DEP did not have confidence in its ability to satisfy the Fixed MMQ in the short term. Second, according to witnesses Halm and Coppola the issue is not whether DEP would have been able to satisfy its delivery obligation over a single year, but whether it could satisfy its obligation over the entire term of the 2012 Agreement. Id. at 187-188.

DISCUSSION AND CONCLUSIONS

Legal Standard

Pursuant to N.C.G.S. § 62-133.2(d), in pertinent part:

> [I]n reaching its decision the Commission shall consider all evidence required under subsection (c) of this section as well as any and all other competent evidence that may assist the Commission in reaching its decision…
>
> [T]he burden of proof as to the correctness and reasonableness of the charge and as to whether the cost of fuel and fuel-related costs were reasonably and prudently incurred shall be on the utility.

The prudence and reasonableness standard applied by the Commission is generally stated as:

> [w]hether management decisions were made in a reasonable manner and at an appropriate time on the basis of what was reasonably known or reasonably should have been known at that time (citation omitted)…The Commission notes that this standard is one of reasonableness that must be based on a contemporaneous view of the action or decision under question. Perfection is not required. Hindsight analysis – the judging of events based on subsequent developments – is not permitted.

Order Granting Partial Increase in Rates and Charges, *Application by Carolina Power & Light Company for Authority to Adjust and Increase Its Rates and Charges*, No. E-2, Sub 537, at 14 (N.C.U.C. Aug. 5, 1988), *rev'd in part on other grounds and remanded*, *Utils. Comm'n v. Thornburg*, 325 N.C. 484, 385 S.E.2d 463 (1989) (Harris Order).

In the Harris Order the Commission stated that challenging prudence requires a detailed and fact intensive analysis, and the challenger is required to (1) identify specific and discrete instances of imprudence; (2) demonstrate the existence of prudent alternatives; and (3) quantify the effects of the imprudence on ratepayers. Harris Order, at 252.

As a general rule, if the utility presents evidence supporting the reasonableness and prudence of an act and no evidence challenging the reasonableness or prudence is presented, then a prima facie case is made as to reasonableness and prudence. *State ex rel. Utilities Comm'n. v. Intervenor Residents*, 305 N.C. 62, 76-77, 286 S.E.2d 770, 779 (1982).

In the present case witness Lucas testified about three factors that led to the reduced dispatch of the Roxboro units: (1) the JDA, (2) the sustained decline in natural gas prices, and (3) DEP's and DEC's conversion from coal-fired generation to natural gas-fired generation. In the Interim Order the Commission concluded that all of these facts were known to DEP when it entered into the 2012 Agreement with CTG on August 1, 2012. Nevertheless, DEP negotiated and signed the 2012 Agreement that committed it to deliver 50,000 tons of gypsum per month from the Roxboro Plants through April 2029, and to maintain a gypsum stockpile of 250,000 tons for that same period of time. The Commission concluded that the evidence presented by Public Staff witness Lucas regarding the JDA, natural gas prices, and DEP's and DEC's conversion from coal-fired generation to natural gas-fired generation was substantial evidence that rebutted DEP's *prima facie* case of the prudence and reasonableness of its decisions and actions in connection with the 2012 Agreement. As a result, the burden of proof on this issue remained with DEP.

With respect to whether DEP acted prudently in entering into the 2012 Agreement, witness Lucas stated that

> The Public Staff concludes that it was unreasonable and imprudent for DEP to enter into the 2012 Agreement as it was written, especially when, as was concluded in the lawsuit, DEP was offered the opportunity to enter into a

> more flexible arrangement. Therefore, at least some of the costs arising out of the lawsuit with CertainTeed should be excluded from recovery.

Tr. Vol. 3, 30

On the other hand, the DEP Panel concluded that DEP's actions were reasonable and prudent. Tr. Vol. 3, 164.

Specific and Discrete Instances of Imprudence

The Commission finds and concludes that at the time that the 2012 Agreement was being negotiated by DEP and CTG, and before it was signed in August 2012, DEP's management knew, or reasonably should have known, that the effect of the merger, and specifically the JDA, was projected to result in the increased dispatch of the more efficient DEC coal units and the decreased dispatch of the DEP coal units, including Roxboro and Mayo. In connection with this finding the Commission gives substantial weight to the Compass Lexecon Study, and in particular Exhibit 1 to the Study showing that beginning with 2012 the utilization of DEC's large coal-fired generating units would increase across the majority of months, while the utilization of DEP's large coal-fired generating units would decrease across the majority of months. The Commission further notes that the Study was filed as Exhibit 4 of the merger application as a public document. Obviously, witness Coppola had access to the Study. Further, Company management was obviously aware of the Study.

The Commission further finds and concludes that at the time the 2012 Agreement was being negotiated by DEP and CTG, and before it was signed in August 2012, DEP was engaged in a steady transition from the use of coal-fired generation to the use of natural gas-fired generation, including the retirement of coal-fired plants as soon as gas-fired CCs came online to replace the coal plants. The Commission gives substantial weight to Public Staff witness Lucas's testimony on this point. The Commission also notes that the DEP witnesses presented no substantial evidence to refute this point.

In addition, the Commission gives significant weight to witness Lucas' testimony about the drop in natural gas prices that began around 2009 and was continuing, or at a minimum was sustained, through August 2012. The DEP Panel testified that, "Specifically, due to the decrease in natural gas prices, the dispatch of Roxboro and Mayo Generating Stations decreased and therefore the amount of synthetic gypsum produced decreased." Tr. Vol. 2, 146. Yet, they provided no testimony about how, or whether, the sustained decrease in natural gas prices from around 2009 to August 2012 was used by them in assessing whether DEP could meet the Fixed MMQ under the 2012 Agreement.

Based on the evidence concerning natural gas prices, the potential effects of the JDA, and DEP's conversion to natural gas-fired generation, the Commission concludes that DEP should have been cautious in assessing whether these developments would reduce its coal-fired generation substantially, and, consequently, could result in DEP's failing to meet the Fixed MMQ for the 17-year term of the 2012 Agreement. That level of

cautiousness is not apparent from the evidence presented by DEP regarding its negotiations with CTG. In particular, the evidence tends to show that after DEP received the Roxboro Scenarios and the CTG Redline it did not engage in significant negotiations with CTG around the possibility of additional flexibility in its supply obligation and CTG's acceptance obligation. According to Engelhardt, DEP's response to the CTG Redline was essentially that it did not want to negotiate further because it was satisfied with the quantity terms of the 2008. Lucas Exhibit 4, pp. 157-59

In addition, in response to questions from the Commission about why DEP rejected CTG's offer to set the stockpile minimum at 100,000 tons, witness Coppola stated

> Yeah. So there certainly was a potential for the 100,000-ton stockpile to be a requirement with damages. It's hard to say because we didn't get down to that level of granularity in the negotiations because we took a different path, the path that we finally ended up with in the 2012 Agreement[.]

Tr. Vol. 3, 212.

As the Commission has previously concluded, CTG was not reasonably likely to give up the supply certainty established in the 2004 and 2008 Agreements, even though the Roxboro Scenarios and the CTG Redline suggest that CTG may have been willing to consider some flexibility with respect to month-to-month quantities delivered. Nevertheless, the Commission would have found it instructive to have some evidence from DEP as to why DEP did not explore the possibility of more flexibility in meeting its obligation. CTG initiated negotiations for a revision of the 2008 Agreement with proposals that signaled possible receptiveness to some degree of flexibility, but DEP offered the Commission no explanation whatsoever as to why it declined to explore the extent of CTG's possible openness to flexibility. The only substantive change resulting from the negotiations was DEP's agreement to establish a minimum stockpile obligation of 250,000 tons, an obligation that did not exist in the 2008 Agreement. This result leaves the Commission wondering what DEP received and CTG gave up, if anything, in return for this new minimum stockpile obligation on DEP.

Further, in both the Business Court and before the Commission DEP witness Coppola testified that the intent of DEP and CTG was to negotiate and enter into a variable supply contract. Tr. Vol. 2, 165-66; Judgment, Finding of Fact No. 107. As the Business Court concluded, the 2012 Agreement was ambiguous on that point, leading the court to take extensive testimony on the intent of the parties and ultimately to conclude that the 2012 Agreement was intended by DEP and CTG to be a fixed supply contract requiring DEP to deliver 50,000 tons per month. *Id.*, Finding of Fact Nos. 120-131. It would not appear difficult for DEP to have drafted language that unambiguously stated the parties' intent that DEP would deliver and CTG would accept the amount of gypsum produced at the Roxboro Plants. The Commission expects DEP to exercise more care in drafting its contract language in the future.

With respect to whether the evidence of record in this proceeding demonstrates imprudence by DEP, the Commission concludes that DEP presented substantial evidence of its prudence and the Public Staff presented substantial evidence tending to show DEP's imprudence. Ordinarily, the Commission would continue its analysis by weighing the competing evidence and making a determination of prudence or imprudence from a preponderance of the evidence. In this instance that determination is made more difficult by the very sparse evidence concerning the parties' motives, objectives, or evaluation of possible options. However, ultimately, the Commission has found that it need not engage in the exercise since the dispositive elements are the second and third *Harris* criteria.

Existence of Prudent Alternatives

As previously discussed, the Roxboro Scenarios and CTG Redline were an invitation by CTG for the exploration of more flexibility in the contract between the parties. The Roxboro Scenarios included three concepts relating to gypsum supply and acceptance by the parties. . . From the four corners of the document setting out the scenarios it would appear that CTG was potentially willing to contemplate flexibility not only with respect to monthly delivery quantities but also, possibly, with respect to the annual minimum delivery requirement. The Commission is unable to conclude from this, however, that the Roxboro Scenarios document can carry the weight the Public Staff ascribes to it. There is no evidence that any significant negotiations were premised on the Roxboro Scenarios, and the Commission cannot engage in speculation about what would have happened during any hypothetical negotiations around the Roxboro Scenarios or whether those negotiations might have ultimately led to an executed agreement more favorable to DEP, one with quantity terms that could have been performed by DEP over an extended period without breach. Contract negotiations involving complex commercial agreements such as the one at hand in this case often take unexpected or unpredictable turns; the positions of parties change and morph as different competing considerations are weighed, and what starts out as a simple concept sheet may become in the end an elaborate document whose terms bear only a small resemblance to where the negotiations began.

The Roxboro Scenarios were followed almost immediately by Engelhardt providing to DEP the CTG Redline. That contract proposal can be read as a definite and firm offer for DEP's consideration, but it does not track the Roxboro Scenarios and, most importantly of all, it stipulates a minimum 600,000 annual ton delivery requirement. Whatever flexibility the CTG Redline may have offered DEP with respect to monthly quantities and stockpile levels, it did not offer the prospect of dropping the fixed minimum annual quantity. In some respects, the annual 600,000-ton gypsum supply obligation proposed by CTG in the CTG Redline might have been less burdensome than the 50,000-ton Fixed MMQ agreed to by DEP in the 2012 Agreement. If there is one certainty in the electric utility business it is that the generation levels of electric plants vary from month to month based on a myriad of factors, including weather, maintenance needs, and the availability of other generating plants. Thus, for example, it might have been helpful for DEP to have the flexibility of making up quantities of gypsum missed during the months

of January and February due to a mild winter with quantities produced in July and August as the result of a hot summer. Standing alone, the choice of an annual requirement of 600,000 tons of gypsum versus a monthly requirement of 50,000 tons might be the reasonable choice.

However, as DEP maintained in its testimony the terms of the CTG Redline had to be considered by DEP in their entirety, not piecemeal. In particular, the DEP Panel testified that one reason DEP rejected the CTG Redline was that it "introduced new and potentially onerous provisions concerning DEP's obligation to maintain a minimum Stockpile." Tr. Vol. 3, 174. As an example of this, in its Post-Hearing Brief DEP discussed the lack of a defined monthly supply/acceptance amount in the CTG Redline, and contended, therefore, that the CTG Redline would enable CTG to take any amount of gypsum off of the stockpile at any time, thus potentially requiring DEP to replenish the stockpile on a regular basis. DEP also cited the Business Court Judgment as reaching this conclusion. DEP Brief, at 11-12.

In addition, the CTG Redline liquidated damages provisions offered nothing substantively different from the corresponding section of the 2012 Agreement. In the 2012 Agreement, the liquidated damages provision stated the following grounds for CTG's receipt of liquidated damages, in pertinent part:

> Discontinued Supply bv Progress Energy. If Progress Energy …(b) takes any action that prevents or will prevent Progress Energy from supplying at least fifty percent (50%) of the Minimum Monthly Quantity each month over a five (5) year period, or (c) takes any other action that causes Progress Energy to supply 300,000 Net Dry Tons or less Gypsum Filter Cake per year in two (2) consecutive Contract Years [.]

In subsection (b), the CTG Redline struck the word "Monthly" and replaced it with "Annual." At first glance, this would appear to be an advantage, as instead of being liable for liquidated damages if DEP missed delivering 25,000 tons during just one month a year in five consecutive years under subsection (b) of the 2012 Agreement, under the CTG Redline DEP would only be liable for liquidated damages if it failed to supply 300,000 tons every year for five consecutive years. However, the CTG Redline also retained subsection (c), thus cancelling any advantage that subsection (b) may have provided. The confused drafting in this provision reinforces the need for caution in drawing any conclusion about whether or not the CTG Redline would have led to a final, executed agreement on terms more favorable to DEP than the 2012 Agreement itself.

Based on a consideration of all the evidence the Commission is unable to identify a specific alternative agreement that would have resulted from DEP's attempt to negotiate based on the Roxboro Scenarios or the CTG Redline <u>and that</u> would have contained final, executed terms more favorable to DEP than the 2012 Agreement. In particular, the Commission concludes from the evidence that there was no reasonable likelihood that any alternative agreement resulting from such negotiations would not have contained both (i) a 600,000 ton minimum annual quantity commitment, and (ii) a provision putting

DEP in breach if it failed to deliver at least 50% of the minimum annual quantity, or at least 300,000 tons, for two consecutive years.[3]

Quantification of Alleged Imprudently Incurred Costs

Witness Lucas testified that on March 9, 2017, DEP sent CTG a letter notifying CTG that the gypsum stockpile would fall below the required minimum under the 2012 Agreement. He further testified that DEP failed to meet the 50,000 tons per month requirement in May and June 2017, and September 2017 through January 2018. Tr. Vol. 2, 64.

The DEP Panel testified that even if DEP had chosen to accept the terms of the CTG Redline it would have ended up defaulting and paying liquidated damages. Tr. Vol. 3, 247-48. Further, the DEP Panel testified as follows:

> Q How did the Company go about deciding whether or not to elect to discontinue supply under the Agreement at the time it did so?
>
> A We evaluated the long-term forecast, the short and long-term forecast, and it did not appear that we would be making enough material to satisfy the Agreement and that it would drop to substantially lower numbers, drop well below 50 percent of the obligation, and that we had reviewed what the cost would be associated with getting alternate material from other sources, we looked internally and externally, and found that material would not be available consistently enough and the price was - exceeded our other options that we had per, I believe, Section 6.2.

Tr. Vol. 3, 246. This is the substance of DEP's position that had it accepted the CTG Redline, which was the only definite offer made by CTG in the 2011-2012 negotiations, it still would have ended up in a position of breach, termination, and payment of liquidated damages. In evaluating this contention and applying the third Harris Order criterion the Commission thus has sought to consider what, if anything, would have happened differently in the time period 2018-2019 had DEP been subject to the quantity and delivery performance standards under the CTG Redline.

During the hearing, Public Staff witness Lucas was asked questions by the Commission about whether DEP would have defaulted on the contract if DEP had accepted the terms of the CTG Redline, in particular the 100,000-ton stockpile minimum, rather than the 250,000-ton minimum agreed upon in the 2012 Agreement. Witness Lucas

[3] During the hearing the Commission explored whether DEP had options available to it in 2011 other than negotiating a modified agreement and continuing performance under such modified agreement, including options such as attempting to identify potential breaches of the 2008 Agreement by CTG to use either as grounds for terminating the 2008 Agreement entirely or as leverage in negotiating a more favorable new agreement. The DEP Panel testified that DEP had explored such options but had concluded that it did not have grounds to declare CTG in default or in breach of the 2008 Agreement. Tr. Vol. 3, 200-202. The Public Staff witnesses did not dispute this testimony.

testified that the Public Staff had not performed an assessment of whether DEP would have defaulted under the terms of the CTG Redline. Tr. Vol. 3, 131-135. This lack of analysis by the Public Staff places the Commission in a position of uncertainty and speculation as to whether ratepayers would have been better off if DEP had decided to accept the terms of the CTG Redline. The Commission must make its decisions based on substantial evidence, not on speculation.

In consequence of the Public Staff's failure to analyze the likely outcome of DEP performance under the CTG Redline and in order to probe the DEP Panel's contention concerning that outcome on May 28, 2020, the Commission entered its Order Requiring Filing of Post-Hearing Exhibit, that exhibit being an affidavit that had been filed by witness Halm in the Business Court (Halm Affidavit). Mr. Halm referred to that affidavit in his testimony before the Commission in response to questions about whether DEP would have been able successfully to maintain performance under the CTG Redline. The Halm Affidavit, dated February 28, 2018, tends to support DEP's position that it would have ended up being in breach of the either the CTG Redline or the 2012 Agreement in the long-term. In summary, the Affidavit showed that DEP was steadily losing ground in its effort to supply at least 300,000 tons of gypsum per year, the trigger level, if sustained for two consecutive years, for a potential default and breach by DEP of the 2012 Agreement. The Halm Affidavit showed that during 2017 CTG accepted an average of 37,679 tons of gypsum per month, and that DEP was able to meet this demand and maintain the stockpile at the required 250,000 tons by bringing 20,000 tons of gypsum from DEC's Belews Creek plant from July 2017 through January 2018. In addition, the affidavit stated

> DEP forecasts that its Roxboro and Mayo Plants will produce 57,565 net dry tons of Gypsum Filter Cake between March 2018 through June 2018, a total of 213,365 net dry tons of Gypsum Filter Cake in 2018, and a total of 241,099 net dry tons of Gypsum Filter Cake in 2019.

Halm Affidavit, at 6.

DEP's forecast of 2018 and 2019 gypsum production from the two plants, if considered alone and if actually achieved, would have fallen short of both the 600,000 ton annual commitment contained in the 2012 Agreement and in the CTG Redline and, more importantly, the 300,000 ton annual threshold for triggering potential default and remedies under both the 2012 Agreement and the CTG Redline.

The Commission must, however, also consider the availability of gypsum previously produced by DEP and stockpiled under the agreement. The analysis here is different with respect to the 2012 Agreement and the CTG Redline. Under the 2012 Agreement DEP was to keep the minimum stockpile level at no less than 250,000 tons. The Halm Affidavit establishes that after March, 2017, and for the remainder of 2017 the stockpile (above grade and base quantities combined) never exceeded 206,000 tons and that in June, 2017, it fell as low as approximately 121,000 tons. At the beginning of 2018, the stockpile (combined amounts) stood at approximately 158,000 tons. While this amount could have been drawn upon during 2018 and 2019 to supplement production of

gypsum from the two plants, and thereby enable DEP's deliveries to remain above, but only just barely above, the 300,000 ton annual triggering point, drawing down the stockpile for that purpose would only have put DEP further in violation of its obligation to maintain a minimum stockpile of 250,000 tons.

Under the proffered CTG Redline the minimum stockpile level was reduced to 100,000 tons. The Halm Affidavit indicates that at all times during 2017 and at the beginning of 2018 the below grade, or "base," stockpile contained an estimated 120,842 net dry tons. While this amount, considered in isolation, would have been sufficient to satisfy DEP's 100,000 ton minimum stockpile obligation, it would have left very little above ground quantities available for DEP to use to supplement production from the two generating plants. In January, 2018, the above ground portion of the stockpile contained only 37,391 dry tons. This was manifestly inadequate to enable DEP to maintain a minimum annual delivery of 300,000 tons during 2018 and 2019, assuming its production forecast proved accurate. Moreover, as already noted, even if DEP had exhausted the entire stockpile available to it as of January 2018, it would only barely have been able to deliver 300,000 tons to CTG in 2018 and again in 2019. Based on the Halm Affidavit it thus appears that the more favorable terms of the CTG Redline with respect to the minimum required stockpile level would, at the very best, have bought DEP only a few months more time before it would have faced the same situation of potential default and breach that faced it in 2018. With respect to the third Harris Order criterion the Commission concludes from the preponderance of the evidence that even if DEP had accepted the CTG Redline exactly as it was tendered, DEP would have been unable to perform for the remaining term of the agreement and would, by some time likely in 2018 or 2019, have been facing the same choice whether to continue under the agreement or to terminate and pay liquidated damages that confronted it after the Business Court rendered its judgment.

Based on the evidence in the record, the Commission finds and concludes that by 2018 or 2019 DEP would have been in the same position under the terms of the CTG Redline as it was under the terms of the 2012 Agreement. As a result, DEP's rejection of the terms of the CTG Redline does not result in a quantifiable difference to ratepayers.

Because the Commission has concluded that neither the second nor the third criteria in the Harris Order are satisfied on this record, DEP's request for recovery in its fuel rider of the amount of damages awarded by the Business Court and the liquidated damages paid to CTG are not subject to disallowance on grounds of imprudence, even if the Commission were to find that DEP's failure to negotiate for more flexibility in the supply terms of the 2012 Agreement was imprudent.

EVIDENCE AND CONLUSIONS FOR FINDINGS OF FACT NOS. 18-19

The evidence supporting these findings of fact and conclusions is contained in the direct and supplemental testimony of Public Staff witness Lucas, the pre-filed direct testimony of Company witness Dana Harrington, the rebuttal and supplemental rebuttal testimony of Company witnesses Coppola and Halm, and the Business Court Judgment.

On August 28, 2018, the Business Court ruled in CTG's favor, and ordered DEP to pay $1,084,216 to reimburse CTG for the cost of transportation that DEP had charged CTG for bringing replenishment gypsum from Belews Creek from July 2017 through January 2018, and to provide a replenishment plan for meeting the 2012 Agreement's supply requirements within 90 days. Judgment, at 77-82.

Witness Lucas testified that DEP and CTG reached a settlement on October 1, 2018, in which DEP agreed to pay liquidated damages in return for being released from its remaining obligations under the 2012 Agreement, except for a commitment to deliver a minimum amount of gypsum for approximately two years. Tr. Vol. 2, 65-68. The settlement was introduced into evidence as Confidential FPWC Harrington Cross-Exam Exhibit 4.

In prefiled direct testimony, DEP witness Dana Harrington testified regarding the Company's proposed adjustment relating to liquidated damages being paid over a ten-year period by DEP. Witness Harrington testified that DEP was requesting that the North Carolina retail portion of the liquidated damages be recovered from ratepayers over the next ten years, and that DEP had reflected this amount in its fuel cost application in this docket by: (1) a $6.6 million addition to the proposed Experience Modification Factor (EMF), and (2) a $5 million addition to DEP's proposed prospective fuel rates for December 2019 through November 2020. Tr. Vol. 1, 96-97. The DEP Panel testified that the Company ultimately determined that discontinuing supply under the 2012 Agreement and paying liquidated damages was the most prudent option for customers. Tr. Vol. 3, 165-66. Public Staff witness Lucas agreed. *Id.* at 21. In addition, the DEP Panel testified that CTG is today continuing to accept gypsum from DEP pursuant to an Interim Supply Agreement. Tr. Vol. 2, 194-96; Confidential FPWC Harrington Cross-Exam Exhibit 4.

In its Post-Hearing Brief DEP explained that the contract damages ordered in the Judgment, $1,010,938.20, was a reimbursement to CTG of the transportation costs for gypsum transported by DEP from Belews Creek to replenish the stockpile, as noted above in the DEP Panel's testimony. These transportation costs were paid by CTG under protest, subject to resolution in the court case. DEP stated that the North Carolina portion of the transportation costs requested for recovery in this case is $619,225.99. DEP Brief, at 34.

DISCUSSION AND CONCLUSIONS

Based on a preponderance of the evidence, the Commission finds and concludes that it is reasonably likely that DEP would have incurred the transportation costs of bringing replenishment gypsum from Belews Creek to Roxboro even if DEP had chosen to accept the terms of the CTG Redline. Therefore, DEP should be allowed to recover the North Carolina portion of the transportation costs from its ratepayers.

Further, the Commission finds and concludes that after entry of the Business Court Judgment it was reasonable and prudent for DEP to pay the contract damages ordered by the court and to terminate the 2012 Agreement and pay liquidated damages to CTG.

As a result, DEP should be allowed to recover in its fuel costs the North Carolina allocable portion of the liquidated damages being amortized over a ten-year period, as testified to by DEP witness Harrington.

IT IS, THEREFORE, ORDERED as follows:

1. That DEP's request to recover the liquidated damages paid and remaining owing to CTG from ratepayers shall be, and is hereby, approved;

2. That DEP shall be, and is hereby, allowed to recover the North Carolina portion of its gypsum transportation costs, $619,225.19, from ratepayers; and

3. That DEP shall add the North Carolina allocable portion of the liquidated damages being amortized over a ten-year period and the gypsum transportation costs of $619,225.19 to its Experience Modification Factor in its 2020 fuel adjustment proceeding presently pending in Docket No. E-2, Sub 1250.

ISSUED BY ORDER OF THE COMMISSION.

This the 28th day of July, 2020.

NORTH CAROLINA UTILITIES COMMISSION

Kimberley A. Campbell, Chief Clerk