STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 828
DOCKET NO. E-7, SUB 829
DOCKET NO. E-100, SUB 112
DOCKET NO. E-7, SUB 795

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-7, SUB 828 In the Matter of Duke Energy Carolinas, LLC – Investigation of Existing Rates and Charges Pursuant to Regulatory Condition No. 76 as Contained in the Regulatory Conditions Approved by Order Issued March 24, 2006, in Docket No. E-7, Sub 795 DOCKET NO. E-7, SUB 829 In the Matter of Duke Energy Carolinas, LLC – Investigation of Environmental Compliance Costs Pursuant to G.S. 62-133.6(d) and (f) DOCKET NO. E-100, SUB 112 In the Matter of Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 158 Entitled "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" and DOCKET NO. E-7, SUB 795 In the Matter of Application of Duke Energy Corporation 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 STIPULATION AND DECIDING NON-SETTLED ISSUES

BEFORE: Commissioner Sam J. Ervin, IV, Presiding; Chairman Edward S. Finley, Jr.; and Commissioners Robert V. Owens, Jr., Lorinzo L. Joyner, James Y. Kerr, II, Howard N. Lee, and William T. Culpepper, III

HEARD: Tuesday, August 14, 2007, at 6:30 p.m., Mazie Woodruff Center, 2100 Silas Creek Parkway, Winston-Salem, North Carolina

Wednesday, August 15, 2007, at 7:00 p.m., Charlotte-Mecklenburg Government Center, 600 E. Fourth Street, Charlotte, North Carolina

Tuesday, September 4, 2007, at 7:00 p.m., County Commissioners' Chambers, Durham County Government Administrative Center, 200 E. Main Street, Durham, North Carolina

Wednesday, September 19, 2007, at 7:00 p.m., Downstairs Courtroom, McDowell County Courthouse, Corner of Main and Court Streets, Marion, North Carolina

Thursday, September 20, 2007, at 7:00 p.m., Courtroom A, Macon County Courthouse, 5 W. Main Street, Franklin, North Carolina

Tuesday, October 16 and Wednesday, October 17, 2007, at 9:00 a.m., Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina

APPEARANCES:

For Duke Energy Carolinas, LLC:

Robert W. Kaylor, Law Offices of Robert W. Kaylor, P.A., 225 Hillsborough Street, Suite 160, Raleigh, North Carolina 27603

Kodwo Ghartey-Tagoe, Lara S. Nichols, and Lawrence B. Somers, 526 South Church Street, EC03T, Charlotte, North Carolina 28202

For the Using and Consuming Public:

Antoinette R. Wike, Gisele L. Rankin, Dianna Jessup, Kendrick Fentress, and William E. Grantmyre, Public Staff - North Carolina Utilities Commission, 4326 Mail Service Center, Raleigh, North Carolina 27699-4326

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For the Carolina Utility Customers Association, Inc:

James P. West, West Law Offices, P.C., Post Office Box 1568, Raleigh, North Carolina 27602

For the Carolina Industrial Group for Fair Utility Rates III:

Ralph McDonald, Bailey & Dixon, L.L.P., Post Office Box 1351, Raleigh, North Carolina 27602-1351

For Wal-Mart Stores East, LP:

Rick D. Chamberlain, Behrens, Wheeler & Chamberlain, 6 N.E. 63rd Street, Suite 7400, Oklahoma City, Oklahoma 73105

BY THE COMMISSION: On March 9, 2007, in keeping with Regulatory Condition No. 76 set forth in its Order dated March 24, 2006, in Docket No. E-7, Sub 795 (the Merger Order), the Commission issued its Order Initiating Proceedings, Instituting Investigations, and Setting Hearing, in which the Commission opened Docket Nos. E-7, Subs 828 and 829 as consolidated dockets for the purposes of initiating an investigation of the rates and charges of Duke Energy Carolinas, LLC (Duke or the Company) pursuant to G.S. 62-130(d), 62-133, and 62-136(a) and initiating an investigation of the environmental compliance costs of the Company as required by G.S. 62-133.6(d). In that Order, the Commission directed Duke, not later than May 15, 2007, to either (1) file a general rate case pursuant to G.S. 62-137 or (2) show cause why its existing rates and charges should not be found unjust and unreasonable and, in either case, to file by the same date a Rate Case Information Report using Form E-1. That Order also declared the proceedings in Docket No. E-7, Sub 828 to be a general rate case; declared the test period to be the 12-month period ending December 31, 2006; established the hearing schedule for the consolidated proceedings; ordered the Company to file testimony and exhibits supporting its proposals in Docket No. E-7, Sub 829 pursuant to G.S. 62-133.6(i) by May 15, 2007; and established a schedule for discovery and for the filing of testimony and exhibits by intervenors and the Public Staff of the North Carolina Utilities Commission (Public Staff) and rebuttal testimony and exhibits by the Company. The May 15, 2007 due date was subsequently extended to June 1, 2007.

Petitions to intervene were filed by the Carolina Industrial Group for Fair Utility Rates III (CIGFUR III) on March 13, 2007, and by the Carolina Utility Customers Association, Inc. (CUCA) on March 19, 2007. On March 16 and 21, 2007, respectively, the Commission entered Orders granting the petitions of CIGFUR III and CUCA. The North Carolina Attorney General's Office gave notice of its intervention on May 30, 2007. The intervention and participation of the Attorney General was recognized pursuant to G.S. 62-20. On August 13 and 21, 2007, respectively, Wal-Mart Stores East LP (Wal-Mart) and the North Carolina Municipal Power Agency No. 1 (NCMPA) filed petitions to intervene. On August 17, 2007, the Commission granted Wal-Mart's petition to intervene. On August 24, 2007, Duke filed objections to the NCMPA's petition to intervene, and on September 13, 2007, the Commission denied the petition to intervene by the NCMPA. The intervention and participation of the Public Staff was recognized pursuant to G.S. 62-15 and Commission Rule R1-19(e).

On May 4, 2007, the Commission issued an Order consolidating Docket No. E-100, Sub 112 with these dockets for the purpose of receiving evidence concerning the issue of Duke's compliance with Commission Rule R8-27 in connection with the accounting treatment that it proposed for the purpose of implementing Statement of Financial Accounting Standards No. 158 (SFAS No. 158).

On June 1, 2007, Duke filed its Application for Authority to Adjust and Increase its Rates and Charges, along with a Form E-1 Rate Case Information Report and the direct testimony and exhibits of James E. Rogers; Ellen T. Ruff; Robin T. Manning; John J. Roebel; Henry B. Barron, Jr.; Lynn J. Good; Steven M. Fetter; Dr. James H. Vander Weide; Dwight L. Jacobs; Jane L. McManeus; Carol E. Shrum; Jeffrey R. Bailey; and John J. Spanos.

On June 21, 2007, the Commission issued its Order Scheduling Public Hearings and Requiring Public Notice Thereof.

On August 2, 2007, the Commission entered an Order consolidating the Company's application in Docket No. E-7, Sub 831 for approval of the "Save-a-Watt" approach to energy efficiency (EE) with these dockets. On August 14, 2007, Duke filed a motion for reconsideration seeking to have Docket No. E-7, Sub 831 severed from these dockets. After the enactment of North Carolina Session Law 2007-297 (Senate Bill 3), the Commission issued its Order bifurcating Docket No. E-7, Sub 831 from these dockets on August 31, 2007.

On September 13, 2007, the Public Staff proposed by letter that the first audit report by the independent auditor, The Liberty Consulting Group (Liberty), due on October 1, 2007, be entered into evidence in this proceeding, along with the credentials of John Antonuk, Liberty's President, who would be the witness for Liberty. On September 20, 2007, the Commission entered an Order granting the Public Staff's request and establishing a date certain for Mr. Antonuk's testimony. The Liberty Audit Report was filed on October 1, 2007.

On September 4, 2007, Duke filed affidavits of publication indicating that public notice had been provided in accordance with the Commission's procedural Orders.

Between August 14, 2007, and September 20, 2007, public hearings were held in Winston Salem, Charlotte, Durham, Marion, and Franklin for the purpose of receiving public testimony.

On September 10, 2007, Duke filed the supplemental direct testimony of James E. Rogers, Jeffrey R. Bailey, and Carol E. Shrum.

On October 5, 2007, the parties filed an Agreement and Stipulation of Partial Settlement (Stipulation) setting forth areas of agreement and nonagreement among all of the parties of record (the Stipulating Parties). On the same date, Duke filed the supplemental testimony of Ellen T. Ruff; the Public Staff filed the direct testimony of Darleen P. Peedin, Michael C. Maness, Jack L. Floyd, and Dr. Ben Johnson; and CIGFUR III filed the direct testimony of Nicholas Phillips, Jr. CUCA and Wal-Mart filed separate statements in support of the Stipulation.

On October 11, 2007, Duke filed the direct testimony of Barbara G. Yarbrough and the rebuttal testimony of Ellen T. Ruff, Jeffrey R. Bailey, Dr. Julius A. Wright, and Nancy J. Horsley.

Also, on October 11, 2007, the Commission issued its Pre-Hearing Order, which designated the times and place of the hearing and the order of witnesses, fixed the times for filing post-hearing briefs and proposed orders, and directed Duke to file exhibits based on the Stipulation setting out the settled position before the additional litigated issues.

At the request of Duke and the Public Staff, respectively, the Commission on October 12, 2007, entered an Order excusing Company witnesses James E. Rogers; Robin E. Manning; John J. Roebel; Henry B. Barron, Jr.; Lynn J. Good; Steven M. Fetter; Dr. James H. Vander Weide; and John J. Spanos and Public Staff witness Dr. Ben Johnson from appearing at the hearings, subject to recall by the Commission if needed. In that Order, the Commission also notified the parties that a witness from the North Carolina Department of Environment and Natural Resources (DENR) would testify at the hearing regarding Duke's compliance with the emissions reduction provisions of the Clean Smokestacks Act.

On October 15, 2007, the Attorney General's Office filed a Statement of Position recommending certain changes to Duke's Service Regulations with respect to the definition of "customer" and the provisions relating to the denial and discontinuance of service. Also, on October 15, 2007, the Public Staff filed the affidavit of Elise Cox regarding amounts associated with additional expense items that will be defined as "cost of fuel and fuel-related costs" under the amendments to G.S. 62-133.2 enacted as part of Senate Bill 3, and Duke filed the exhibits required by the Commission's Pre-Hearing Order of October 11, 2007, showing the financial effects of the settlement reflected in the Stipulation before consideration of the additional litigated issues.

The public hearings were held as scheduled. The following public witnesses appeared and testified:

<u>Winston-Salem</u>: Kristie Reid, Robin Rhyne, Larry Law, and Sandra Thomas

<u>Charlotte</u>: Jack Copeland, Jr., James Howard, Donny Hicks, Ron Smidt, and John Nims

<u>Durham</u>: Ted Conner and Bill Kalkaf

<u>Marion</u>: Dave Hart, Tony Young, David Johnson, and Roxanne D. Boyd

<u>Franklin</u>: Verlin Curtis, Dan Roland, Jan Unger, Roy Sargent, Narelle Kirkland, and David Johnson

The matter came on for hearing in Raleigh on October 16, 2007. All prefiled testimony and exhibits filed in these dockets were admitted without objection. All parties agreed to waive cross-examination on the prefiled direct testimony with respect to the settled issues. DENR presented the testimony of Brock Nicholson, Director of the Air Quality Division, regarding Duke's compliance with the emissions limitation provisions of the Clean Smokestacks Act. Duke then presented a panel consisting of Ellen T. Ruff, Carol E. Shrum, Jeffrey R. Bailey, and Barbara G. Yarbrough, which summarized the terms of the Stipulation and answered questions from the Commission regarding the Stipulation. Witness Yarbrough also answered questions and was cross-examined concerning the issues raised by the Attorney General's Office in its Statement of Position. Duke presented the rebuttal testimony of its witnesses Ellen T. Ruff and Dr. Julius A. Wright. The Public Staff presented the testimony of Elise Cox, Darleen P. Peedin, and Michael C. Maness. The direct testimony of Public Staff witness Jack L. Floyd and CIGFUR III witness Nicholas Phillips, Jr., and the rebuttal testimony of Company witnesses Jeffrey R. Bailey and Nancy J. Horsley were admitted into evidence by stipulation.

On October 26, 2007, the Commission issued a Post-Hearing Order requiring responses to its requests for additional information in the form of verified late-filed exhibits and the briefing of certain issues. Between October 26 and November 1, 2007, Duke filed its responses to the inquiries posed by the Commission in its Post-Hearing Order. On November 1, 2007, the Public Staff filed the supplemental affidavit and exhibit of Elise Cox. On November 5, 2007, Duke, the Public Staff, the Attorney General, and CIGFUR III filed their briefs and/or proposed orders and CUCA filed a letter in support of the Stipulation.

On November 29, 2007, the Commission entered a Notice of Decision and Order in these dockets. By that Notice of Decision and Order, the Commission gave notice that it would thereafter enter an Order in these dockets which would:

1. Approve the Stipulation filed by Duke, the Public Staff, the Attorney General, CUCA, CIGFUR III, and Wal-Mart on October 5, 2007, subject to the additional decisions set forth below.

2. Disallow Duke's proposed adjustment to increase test-year operating expenses by $39,925,000 to eliminate gross merger savings which were actually experienced during the last nine months of the test year and, instead, approve the Public Staff's proposed adjustment to test-year operating expenses to reflect an annualized level of merger savings minus fuel savings in the amount of $46,241,000.

3. Announce that the Commission would, pursuant to G.S. 62-80, reconsider one provision of the Merger Order entered in Docket No. E-7, Sub 795 on March 24, 2006. The Commission stated that it would specifically reconsider that provision in Regulatory Condition No. 76 (as discussed in conjunction with Finding of Fact No. 37 in the Merger Order and the Evidence and Conclusions in support thereof) which provides that:

> . . . Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. . . .

The Commission further stated that it had preliminarily concluded that the provisions of the Merger Order will not produce a fair sharing of the benefits of the estimated merger savings between ratepayers and shareholders and that, for that reason, Duke should be authorized to implement a 12-month rate increment rider to collect $80,459,000 from its North Carolina retail customers for the benefit of its shareholders. This amount represents 58% of the annualized level of gross merger savings of $46,241,000 reflected in rates in this proceeding for the next three calendar years (2008, 2009, and 2010). [$46,241,000 gross merger savings per year, times 0.58, times 3 years, equals $80,459,000].

4. Conclude that G.S. 62-133.6(e), the rate freeze provision of the Clean Smokestacks Act, does not apply to GridSouth costs incurred prior to June 2002, and does not prevent the Commission from approving a deferral and amortization of such costs at this time. Therefore, the Commission will approve a 10-year amortization of the costs in the amount of $29,059,000 incurred by Duke in developing the proposed GridSouth Regional Transmission Organization. The amortization will begin in June 2002, and $2,906,000 will be included as an operating expense in Duke's cost of service for purposes of this case. The Company will not be allowed to recover carrying charges which accrued after June 2002, or a return on the unamortized balance of its GridSouth costs for ratemaking purposes in this case.

5. Approve establishment of a regulatory asset in Account No. 182.3 by Duke Energy Corporation with respect to Duke's apportioned share of the funded status of pension and OPEB plan obligations as part of its compliance with SFAS No. 158 and request the Public Staff to examine and evaluate Duke's pension and OPEB plan funding practices and file a detailed report with the Commission setting forth its findings, conclusions, and recommendations. The Order will also authorize the Public Staff, in its discretion and as it deems advisable and necessary, to engage an independent accounting or consulting firm to conduct the examination and evaluation or provide consulting assistance to the Public Staff.

6. Deny the Attorney General's request for amendments to Duke's Service Regulations.

7. Defer consideration of changes to Rider IS (Interruptible Power Service) to Docket No. E-7, Sub 831, and transfer to that docket, in addition to the consideration of the new programs proposed by Duke, the issue of what changes, if any, are appropriate to existing demand side management (DSM) and EE programs, such as Rider IS.

8. Conclude that no portion of any Environmental Compliance Costs directly assigned, allocated, or otherwise attributable to another jurisdiction pursuant to Section 7, Paragraph D of the Stipulation shall be recovered from North Carolina retail customers, even if recovery of those costs is disallowed or denied, in whole or in part, in another jurisdiction.

9. Require Duke to credit all future nuclear property insurance policy distributions to Account 228.1 unless specifically authorized by the Commission to change such accounting practice.

10. Approve a rate reduction of $286,924,000 in annual non-fuel base revenues effective January 1, 2008.

On December 5, 2007, the Commission entered an Order granting an extension of time until Friday, December 14, 2007, for Duke to file the rate schedules required by the Notice of Decision and Order.

On December 12, 2007, Duke filed Motion for Leave to Implement a 12-month increment rider associated with merger savings, consistent with the Notice of Decision and Order, on January 1, 2008, subject to refund.

On December 14, 2007, Duke filed the rate schedules required by the Notice of Decision.

On the same date, Duke filed a letter with the Commission setting forth Duke's response to the service issues presented by witness Roy Sargent at the public hearing held on September 20, 2007, in Franklin, North Carolina.

On December 17, 2007, the Commission entered an Order Requesting Comments on Rate Schedules in these dockets, in which the Commission provided all parties with an opportunity to file comments on the rate schedules filed by Duke on December 14, 2007. On December 19, 2007, the Commission entered an Order Granting Oral Motion for Extension of Time extending the time within which the parties were allowed to file comments on Duke's proposed rate schedules.

WHEREUPON, the Commission now makes the following

FINDINGS OF FACT AND CONCLUSIONS

Jurisdiction

1. Duke Energy Carolinas, LLC (Duke or the Company) is duly organized as a public utility operating under the laws of the State of North Carolina and is subject to the jurisdiction of this Commission. Duke is engaged in the business of generating, transmitting, distributing, and selling electric power to the public in a broad area of central and western North Carolina. Duke is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy), both having their offices and principal places of business in Charlotte, North Carolina.

2. The Commission has jurisdiction over the rates and charges, rate schedules, classifications, and practices of public utilities operating in North Carolina, including Duke, under Chapter 62 of the General Statutes of North Carolina.

3. Duke is lawfully before the Commission based upon its Application for a general increase in its retail rates pursuant to G.S. 62-133 and 62-137 and on its presentation of its environmental plan and compliance costs under the North Carolina Clean Smokestacks Act, particularly G.S. 62-133.6(i).

4. The appropriate test period for use in this proceeding is the 12 months ended December 31, 2006, with appropriate adjustments.

The Stipulation – General

5. Duke, by its Application and testimony and exhibits filed in this proceeding, sought an increase of $140,239,000 or 3.6% in its annual non-fuel revenues from its North Carolina retail electric operations.

6. Duke submitted evidence in this case with respect to revenue, expenses, and rate base using a test period consisting of the 12 months ended December 31, 2006. The Stipulation is based upon the same test period.

7. On October 5, 2007, the Stipulating Parties filed a Stipulation, setting forth areas of agreement and nonagreement between all of the Stipulating Parties. The Stipulation executed by Duke, the Public Staff, the Attorney General's Office, CUCA, CIGFUR III, and Wal-Mart is unopposed by any party. Thus, the Stipulation is a settlement of all matters in these dockets except for those issues, separately addressed in this Order, with respect to which the Stipulating Parties were unable to agree.

8. The Commission, having carefully reviewed the Stipulation and all of the evidence of record, finds and concludes that the provisions of the Stipulation are fair and reasonable under the circumstances of this proceeding and should be approved, subject to the additional decisions set forth in this Order. The specific terms of the Stipulation are addressed in the following findings of fact and conclusions.

The Stipulation – Rates

9. The Stipulation provides for a net reduction of $233,000,000 in Duke's annual non-fuel revenues from its North Carolina retail electric operations. The Stipulating Parties agree that this revenue reduction will result in Company rates that are just and reasonable, subject to the Commission's decision on the issues about which the Stipulating Parties have not agreed. To achieve this reduction, Duke will adjust its North Carolina retail base rates to produce annual revenues of $3,738,696,000 from its North Carolina retail operations. The Stipulating Parties agree that these revenues are intended to provide Duke, through sound management, the opportunity to produce an overall rate of return of 8.57% on a jurisdictional rate base of $7,833,049,000. This overall rate of return is derived from Duke's long-term debt cost of 5.83% and a rate of return of 11% on the common equity component of a capital structure consisting of 47% long-term debt and 53% common equity. The Stipulation provides for allocation of the $233,000,000 rate reduction among the rate classes as set forth in Paragraphs 2D-E of the Stipulation, based upon the billing units recorded in the test year and adjusted for the effects of weather and customer growth, also as set forth in Paragraph 2D of the Stipulation.

10. The Commission has reviewed the Stipulation's provisions for an annual non-fuel revenue decrease of $233,000,000 and finds and concludes that this reduction in the level of base rates to be paid by Duke's North Carolina retail customers, resulting in an overall rate of return of 8.57% on jurisdictional rate base and a return on common equity (ROE) of 11% using a capital structure of 47% long-term debt and 53% common

equity is just and reasonable, subject to the Commission's decisions on the issues about which the Stipulating Parties have not agreed.

11. The Stipulation provides that Duke's rates resulting from this proceeding will be designed to ensure that the industrial class receives a 12.7% decrease, the residential class receives a 3.85% decrease, and the general service class receives a decrease of 7.34% on the General schedule and 5.05% on the OPT–General schedule. The Commission finds and concludes that this allocation of the revenue decrease among the rate classes as set forth in Paragraph 2E of the Stipulation is just and reasonable, subject to the Commission's decisions on the issues about which the Stipulating Parties have not agreed.

12. The Stipulation provides for the transition of the Company's Nantahala Area residential customers to the regular Duke residential schedules RS or RE, giving Nantahala nonresidential customers the option to migrate to comparable Duke schedules, and certain other changes in the Nantahala rate schedules, Service Regulations, and jurisdictional reporting and accounting as more fully described in Paragraphs 3A-E of the Stipulation. The Commission finds and concludes that the provisions in the Stipulation regarding the transition of Duke's Nantahala Area customers to regular Duke rate schedules are just and reasonable and should be approved.

13. The Stipulation provides for a base fuel factor of 1.7371¢/kWh, including gross receipts tax, or 1.6812¢/kWh, excluding gross receipts tax, which the Commission finds and concludes is just and reasonable for purposes of this proceeding. The Commission finds and concludes that the following North Carolina retail amounts included in test period expenses will constitute "fuel related costs" upon the effective dates of North Carolina Session Law 2007-397 (Senate Bill 3) for the purpose of appropriately addressing these costs in future proceedings: (1) costs of reagents consumed in reducing or treating emissions under G.S. 62-133.2(a1)(3) of $3,174,863 or 0.005750277¢/kWh; (2) non-capacity purchase power costs other than fuel under G.S. 62-133.2(a1)(4) of $29,325,989 or 0.053114904¢/kWh; and (3) net gains on coal by-product sales under G.S. 62-133.2(a1)(9) of $3,694,333 or 0.006691134¢/kWh.

14. The Stipulation provides that Duke's rates agreed to in the Stipulation shall be deemed to include 90% of the net revenues from its Bulk Power Marketing (BPM) transactions and 100% of the net revenues from its non-firm point-to-point transmission services experienced in the test year. The Stipulation further provides for a true-up rider to adjust this amount annually on an across-the-board kWh usage basis for all classes of customers. The base rates established in this proceeding include (a) North Carolina retail BPM Net Revenues of $35,471,000 (or 0.0642¢/kWh, excluding gross receipts tax), which consists of 90% of the North Carolina retail portion (allocated on the basis of megawatthour sales) of BPM Net Revenues earned during the test year and (b) Non-Firm Transmission Revenues of $3,697,000 (or 0.0067¢/kWh, excluding gross receipts tax), which consists of 100% of the North Carolina retail portion (allocated on the basis of transmission plant) of Non-Firm Transmission Revenues earned during the test year. Paragraphs 5A-D of the Stipulation set forth the details of

this arrangement. The Commission finds and concludes that these provisions of the Stipulation are just and reasonable.

15. The Stipulating Parties agreed that construction work in progress (CWIP) expenditures for the new Cliffside generating unit incurred as of August 31, 2007, should not be included in Duke's rate base for purposes of this proceeding. The Commission finds and concludes that this provision of the Stipulation is just and reasonable. Furthermore, the total amount of stipulated rate base agreed to by the Stipulating Parties does not include any CWIP. Therefore, the Commission finds and concludes that it is appropriate not to include any CWIP in rate base for purposes of this proceeding.

16. Duke based its filing in this case on the Summer Coincident Peak (SCP) allocation methodology for both jurisdictional and class allocations. The Stipulation provides that Duke may continue to use that methodology, but that the Commission's decision to approve this component of the Stipulation for purposes of this proceeding will not establish a precedent for future general rate cases, and the Company will continue to file annual cost of service studies based on both the SCP and the Summer-Winter Peak and Average (SWPA) methodologies. The Commission finds and concludes that this provision is just and reasonable.

17. The Stipulation provides that Duke's depreciation rates set forth in Spanos Exhibit 1, entitled "Depreciation Study – Calculated Annual Depreciation Accruals Related to Electric Plant as of December 31, 2003", are appropriate for Duke to use in this proceeding and in recording depreciation expense and accumulated depreciation until further Order of the Commission. The Commission finds and concludes that this provision of the Stipulation is just and reasonable.

18. The Stipulation provides that Duke's system nuclear decommissioning costs in the amount of $48.3 million approved in the Commission's Order dated July 29, 2005, in Docket No. E-100, Sub 56, are appropriate for the Company to use and include in the cost of service in this proceeding. The $48.3 million figure is a total-company amount; the North Carolina retail amount is $33.8 million. The Commission finds and concludes that this provision of the Stipulation is just and reasonable.

19. Regarding Duke's existing demand side management (DSM) and energy efficiency (EE) programs, the Stipulation provides that these programs shall continue under the same terms and conditions as are reflected in the Company's existing tariffs (with the exception that the water heating load control provision in Rider LC should be canceled effective January 1, 2008) unless the Commission rules in Docket No. E-7, Sub 831 that the programs should be canceled. The Stipulation also contains the following provisions with respect to these programs:

(a) The rates approved in this proceeding shall be considered to include an across-the-board levelized terminating rider, including a return on the unamortized balance, in the amount of 0.0140¢/kWh (excluding gross receipts tax), that will allow the Company to recover over five years the balance in Duke's

DSM deferred account as of December 31, 2007. The rider is subject to adjustment resulting from changes in the Company's approved cost of capital in a subsequent general rate case during the rider's life. The rider will terminate on December 31, 2012, and the Company's rates shall then be reduced accordingly, on an across-the-board basis.

(b) The rates approved in this proceeding shall be considered to include $15,555,000 of North Carolina retail DSM costs, or 0.0282¢/kWh (excluding gross receipts tax), consisting of load management credits, interruptible service credits, and standby generation payments associated with existing DSM programs.

(c) The DSM deferred account, net of the December 31, 2007 balance, will continue to track the difference between (i) the actual costs of the Company's existing DSM programs, incurred on and after January 1, 2008, and (ii) the amount included in base rates for those programs on a cents per kWh basis. The cost deferral of existing DSM programs will continue to be subject to the provisions of the Commission-approved stipulations in Docket Nos. E-7, Sub 487, E-100, Sub 64, and E-100, Sub 75. A return equal to the overall rate of return (net of income tax) resulting from this rate proceeding will be added to the deferral account on a monthly basis and compounded annually.

(d) The Commission should establish an adjustable rider (which would be called the Existing DSM Program Rider, or EDPR), through which the balance in the Company's DSM deferral account (net of the December 31, 2007 balance) can be trued up in rates on a periodic basis. The deferral account balance would be determined as of each December 31, beginning December 31, 2008. The Company would be required to file its proposed EDPR on April 1 of each year beginning in 2009, to become effective for one year beginning July 1 of that year. Each EDPR must be approved by the Commission before becoming effective. The amount of each year's EDPR shall be distributed to all customer classes on the basis of estimated MWh sales for the period in which the EDPR is effective (July 1 through June 30).

(e) A special provision should be established by the Commission's Order in this proceeding that will allow the EDPR and the DSM deferral account to be modified or eliminated by Commission Order in Docket No. E-7, Sub 831 or Docket No. E-100, Sub 113, so that the EDPR and the deferral account can be appropriately adjusted to reflect the effects of those Orders on the recovery of Duke's DSM and EE costs.

The Commission finds and concludes that these provisions of the Stipulation are just and reasonable.

20. The Stipulation provides for a number of changes in Duke's rate design and Service Regulations, which are set out in detail in Paragraph 10 and Exhibit A of the Stipulation. The Commission finds and concludes that the rate design and Service Regulations proposed by the Company in its Application and in its testimony and exhibits

filed in this proceeding, as modified by the changes agreed upon in the Stipulation, are just and reasonable, subject to the additional decisions set forth below.

21. Under Paragraph 14 of the Stipulation, the Stipulating Parties agree that it remains prudent and reasonable for Duke to record its policy distribution credits for nuclear property insurance to its nuclear insurance reserves account in order to provide possible funding for deductibles in the case of claims related to the Company's nuclear facilities or retrospective premium adjustments relating to claims against the facilities of other insured parties. The Stipulating Parties also agree that the balance in the Company's nuclear property insurance reserve account is currently appropriate and that the treatment of that balance as a rate base deduction in this proceeding is reasonable.

22. The Commission finds and concludes that Paragraph 14 of the Stipulation is reasonable and should be approved. The balance in the Company's nuclear insurance reserve account at the end of the test year was $173 million on a total-company basis and $122 million on a North Carolina retail basis. Duke shall credit all future nuclear property insurance policy distributions to Account 228.1, Accumulated Provision for Property Insurance, unless it is specifically authorized by the Commission to change such accounting practice.

23. Consistent with Paragraph 18 of the Stipulation, the Commission finds and concludes that the overall quality of electric utility service provided by Duke to its North Carolina retail customers is good.

24. Under Paragraph 19 of the Stipulation, Duke agrees not to oppose a petition by the Public Staff that the Commission review and modify the Company's Extra Facilities Charge prior to the Company's next general rate case. The Commission finds and concludes that this provision of the Stipulation is just and reasonable.

25. The Stipulation provides that it is appropriate for Duke to include an adjustment to the cost of service to normalize storm restoration costs for the test period in this proceeding. The Stipulating Parties reserved the right to oppose a request by the Company to defer and amortize future storm restoration costs on the grounds that the request is inconsistent with this normalization. The amount of normalized storm restoration costs included in the cost of service in this proceeding on a North Carolina retail jurisdictional basis is $29,100,000. The Commission finds and concludes that this provision of the Stipulation is just and reasonable.

26. The Commission finds and concludes that it is just and reasonable to include a North Carolina retail amount of net uncollectible expense of $7,510,000 in Duke's test-period operating revenue deductions in this proceeding.

The Stipulation – Clean Smokestacks Act Compliance

27. The Stipulating Parties agreed that they will not challenge as unjust, unreasonable or imprudent Duke's expenditures through December 31, 2006, for emission controls required by the Clean Smokestacks Act (Environmental Compliance Costs) in the amount of $901,380,485. The Commission finds and concludes, based on the evidence of record, that these costs were reasonably and prudently incurred.

28. The Commission finds and concludes that, as of December 31, 2007, Duke will have amortized pursuant to G.S. 62-133.6(b) a total of $1,050,000,000 in Environmental Compliance Costs, as provided in the Stipulation.

29. The Stipulation eliminates $225.2 million of Environmental Compliance Cost amortization from the test-period cost of service. The Stipulating Parties agree that they will not contest the inclusion in rate base of all prudent and reasonable unamortized Environmental Compliance Costs as the projects are closed to plant in service, with such Environmental Compliance Costs being allocated among all jurisdictions and all customer classes. The Commission finds and concludes that this treatment is just and reasonable, but makes no finding at this time as to the reasonableness or prudence of any such unamortized Environmental Compliance Costs. No portion of any Environmental Compliance Costs directly assigned, allocated, or otherwise attributable to another jurisdiction pursuant to Paragraph 7D of the Stipulation shall be recovered from North Carolina retail customers, even if recovery of those costs is disallowed or denied, in whole or in part, in another jurisdiction.

30. Duke's actual and proposed modifications and permitting and construction schedule are adequate to achieve the emissions limitations set out in G.S. 143-215.107D.

The Stipulation – SFAS No. 158 Issue

31. Under Paragraph 8 of the Stipulation, Duke Energy Corporation (Duke Energy) proposes to establish a regulatory asset[1] in Account No. 182.3, Other Regulatory Assets, with respect to Duke's apportioned share of the funded status of pension and other postretirement benefit (OPEB) plan obligations as part of its compliance with the Financial Accounting Standards Board's (FASB's) SFAS No. 158, entitled "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." Because of the materiality[2] and complexity of this issue, the Commission is of the opinion, and so finds and concludes, that the entire matter of pension and OPEB costing and funding from the standpoint of their impact and potential impact on rates should be further examined and evaluated, including examination and evaluation of the interrelationship, if any, that may exist between (a) the amounts of pension and OPEB costs included in the test-period cost of service; (b) the amounts of pension and OPEB costs actually charged to expense and capitalized annually; and (c) the amount of funding actually contributed to the pension trust fund on an annual basis. Therefore, the Commission finds and concludes that this provision of the Stipulation should be approved on a provisional basis, pending completion of the Commission's further review.

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[1] Based on information contained in Duke's November 1, 2007 filing, which was made in response to the Commission's Post-Hearing Order, the total amount of the regulatory asset recorded on Duke Energy's books attributable to Duke, at December 31, 2006, was $550.7 million on a total-company basis. On a North Carolina retail basis, such amount was $385.4 million.

[2] Regarding the amounts of pension and OPEB costs included as expenses in the 2006 test-period cost of service, Duke, in its Late-Filed Exhibit No. 10, filed on October 26, 2007, reported that such amounts were $31.2 million and $19.2 million, respectively, on a North Carolina retail basis.

The Stipulation – Independent Audit Report

32. With respect to the independent audit conducted by The Liberty Consulting Group (Liberty) pursuant to Regulatory Condition No. 32 of the Commission's Merger Order, the Stipulating Parties recommend no adjustment to Duke's cost of service in this proceeding as a result of the Company's affiliate transactions. The Commission agrees, and finds and concludes, that no such adjustment is required at this time. Further, the Commission finds and concludes that all matters related to Liberty's final audit report, filed on October 1, 2007, should be bifurcated from this proceeding and will be addressed by the Commission by further Order.

Issue Not Settled by the Stipulation - Merger Savings

33. It is appropriate to reverse the Company's merger savings adjustment to increase operations and maintenance expenses (O&M) by $39,925,000 and to further reduce expenses to reflect the annualization of merger savings, net of fuel, as recommended by the Public Staff. In addition, the Commission will, pursuant to G.S. 62-80, reconsider one provision of the Merger Order entered in Docket No. E-7, Sub 795 on March 24, 2006. The Commission will specifically reconsider that provision in Regulatory Condition No. 76 (as discussed in conjunction with Finding of Fact No. 37 in the Merger Order and the Evidence and Conclusions in support thereof) which provides that:

> . . . Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. . . .

The Commission has preliminarily concluded that the provisions of the Merger Order will not produce a fair sharing of the benefits of estimated merger savings between ratepayers and shareholders and that, for that reason, Duke should be authorized to implement a 12-month rate increment rider to collect $80,459,000 from its North Carolina retail customers for the benefit of its shareholders. This amount represents 58% of the annualized level of gross merger savings of $46,241,000 reflected in rates in this proceeding for the next three calendar years (2008, 2009, and 2010).

Issue Not Settled by the Stipulation - GridSouth

34. The Commission finds and concludes that it is appropriate to include $2,906,000 as an operating expense in Duke's cost of service to amortize the North Carolina retail portion of its investment in GridSouth incurred prior to the end of June 2002, over a 10-year period beginning June 2002.

Issue Not Settled by the Stipulation – Rider IS

35. The Commission finds and concludes that Rider IS (Interruptible Power Service) should be continued in its present form until the Company's request to discontinue Rider IS is considered in Docket No. E-7, Sub 831. The consideration of what

changes, if any, are appropriate to existing DSM and EE programs, including Rider IS, should be deferred and transferred to Docket No. E-7, Sub 831.

Issue Not Settled by the Stipulation - Service Regulations

36. The Commission finds and concludes that Duke's Service Regulations, attached as Exhibit A to the Stipulation, are reasonable and appropriate and should be approved without the changes proposed by the Attorney General, subject to further Orders of the Commission.

Issue Not Settled by the Stipulation - Final Rate Reduction

37. Based upon the foregoing findings and conclusions, Duke should be required to reduce its annual level of electric operating revenues by $286,924,000 ($233,000,000 plus the $53,924,000 impact of the Commission's decisions on the issues that were not settled by the Stipulation). To achieve this reduction, Duke is required to adjust its North Carolina retail base rates to produce annual revenues of $3,684,772,000 from its North Carolina retail operations, which will allow the Company a reasonable opportunity to earn the overall rate of return on its rate base of 8.57% which the Commission has found just and reasonable.

EVIDENCE IN SUPPORT OF FINDINGS OF FACT AND CONCLUSIONS NOS. 1 - 4

The evidence supporting these findings and conclusions is contained in Duke's verified Application and Form E-1 Rate Case Information Report, the testimony and exhibits of the witnesses, and the entire record in this proceeding. These findings and conclusions are not contested by any party.

EVIDENCE IN SUPPORT OF FINDINGS OF FACT AND CONCLUSIONS NOS. 5 - 8

These findings and conclusions are based on the Stipulation, Duke's verified Application and Form E-1 Rate Case Information Report, the testimony and exhibits of the witnesses for the Company and the Public Staff, and the entire record in this proceeding. These findings and conclusions are not contested by any party.

EVIDENCE IN SUPPORT OF FINDINGS OF FACT AND CONCLUSIONS NOS. 9 - 18, 20 - 22, AND 24 - 26

These findings and conclusions are supported by the Stipulation, Duke's verified Application and Form E-1 Rate Case Information Report, the testimony and exhibits of the witnesses for the Company and the Public Staff, and the entire record in this proceeding. These findings and conclusions are not contested by any party.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 19

The evidence supporting this finding of fact and conclusion is contained in the Stipulation and in the testimony and exhibits of Duke witnesses Rogers, Shrum, and Bailey and Public Staff witness Maness.

At the request of the Commission, Duke provided legal support for the EDPR in its post-hearing filings. Duke noted that there is ample precedent supporting the Commission's authority to approve a tracking rider such as EDPR for periodically truing up the changes in the incremental balance in the Company's DSM deferral account, as proposed in the Stipulation. Citing the testimony of Public Staff witness Maness, Duke further noted that the Commission approved the existing DSM deferral account and special ratemaking treatment, consisting of amortization and recovery in rates for DSM programs, pursuant to G.S. 62-2(a)(3a), which provides:

> It is hereby declared to be the policy of the State of North Carolina: . . .
>
> (3a) To assure that resources necessary to meet future growth through the provision of adequate, reliable utility service include use of the entire spectrum of demand‑side options, including but not limited to conservation, load management and efficiency programs, as additional sources of energy supply and/or energy demand reductions. To that end, to require energy planning and fixing of rates in a manner to result in the least cost mix of generation and demand‑reduction measures which is achievable, <u>including consideration of appropriate rewards to utilities for efficiency and conservation which decrease utility bills</u>. (Emphasis added.)

Duke stated that, given that G.S. 62-2(a)(3a) authorizes the Commission to establish a special ratemaking mechanism implemented through a deferral account, it also provides the Commission with authority to establish a rider as a special ratemaking mechanism. Both mechanisms constitute "rewards" of the type permitted by the statute.

Duke further noted that the Commission has utilized this power on a number of occasions to establish tracking elements in electric utility rates. For example, in Docket No. E-13, Sub 142, <u>In re Nantahala Power and Light Company</u>, Nantahala, which was already tracking its purchased power costs through a monthly "purchased power adjustment clause," sought authority to change to an annually adjustable "provisional" purchased power cost increment, which would be trued up after the year end, with any shortfall or overcollection incorporated in the subsequent year calculations. The Attorney General argued in that case that such a tracker was beyond the Commission's authority, claiming that G.S. 62-133.2 was the only statutory authority permitting the Commission to allow the pass-through of purchased power costs. In its October 19, 1989 Order in that docket, the Commission agreed with Nantahala and the Public Staff that (a) G.S. 62-133.2 did not apply because Nantahala did not generate electricity by use of fossil or nuclear fuels, as that statute requires, and (b) the Commission has general authority under G.S. 62-130 to approve the continued use of the purchased power cost adjustment mechanism. Quoting from its earlier Order in Docket No. E-13, Sub 44, in which it had reauthorized the old monthly adjustment clause, the Commission stated:

> North Carolina G.S. 62-130(d) states that: 'The Commission shall from time-to-time as often as circumstances may require, change or revise, or cause to be changed or revised any rates fixed by the Commission, or allowed to be charged by any public utility.' Pursuant to the authority of this statutory provision, the Commission is of the opinion that it is appropriate for

> Nantahala to continue to adjust its rates through changes in the power adjustment clause. In State of North Carolina ex rel. Utilities Commission v. Edmisten, 291 N.C. 327, 230 S.E.2d 651 (1976), the North Carolina Supreme Court authorized the use of a Commission-approved fuel adjustment clause pursuant to G.S. 62-130. The Court noted that instead of approving fixed monetary rates for electric service, the Commission may approve rates expressed as a formula which will vary with changes in different elements that make up the formula. . . . Based on our interpretation of G.S. 62-130(d) and relevant case law, we conclude that the Commission possesses the necessary authority to approve an annual purchased power adjustment procedure for Nantahala, including an annual true-up of reasonable and prudently incurred purchased power costs.

See also: Utilities Commission v. CF Industries, Inc., 299 N.C. 504, 263 S.E. 2d 559 (1980) (Supreme Court of North Carolina upheld a "curtailment tracking rate" to permit gas utilities to recover the effects of lost revenue resulting from unforeseeable curtailments of supply by gas pipelines); Utilities Commission v. Edmisten, 294 N.C. 598, 242 S.E. 2d 862 (1978) (Supreme Court of North Carolina upheld the Commission's approval of a tracking mechanism for the recovery of natural gas utilities' costs of participation in natural gas exploration programs); Utilities Commission v. Nantahala Power and Light Company, 326 N.C. 190, 388 S.E. 2d 119 (1990) (Supreme Court of North Carolina upheld the Commission's imposition of a rate decrement to pass through to customers the benefits of the 1986 income tax reduction).

Lastly, Duke noted that, given the Commission's authority under G.S. 62-2(a)(3a) and the special circumstances arising from the interim period between when the rates approved in this proceeding become effective and when the Commission issues a decision in the Company's pending Energy Efficiency Docket, Docket No. E-7, Sub 831, it is reasonable and appropriate to approve the EDPR in order to provide for timely recovery of deferred costs as a transition to a recovery mechanism approved under the new G.S. 62-133.8 once the Commission issues an Order in Docket No. E-7, Sub 831 or Docket No. E-100, Sub 113.

The Commission concludes that, as a general proposition, North Carolina law authorizes the Commission to approve a provisional formula rate, with an accompanying true-up mechanism, in situations involving cost items which are uncertain and subject to fluctuation from period to period. The costs associated with the programs subject to the proposed EDPR are uncertain in amount and subject to unpredictable fluctuations so that they can be the subject of a valid provisional or formula rate. In addition, as Duke has pointed out, the proposed EDPR can serve as a "reward" of the type explicitly authorized by G.S. 62-2(a)(3a). All parties to this docket supported approval of the EDPR. The Commission adopted a deferral mechanism for DSM costs in the context of Duke's last general rate case, and a similar deferral mechanism is proposed to be adopted in this proceeding for continuing to track differences in the costs and revenues associated with Duke's existing DSM and EE programs. The EDPR provides a mechanism for recovering or refunding the costs accrued in the deferral account on an annual basis rather than carrying these costs until Duke's next rate case. Thus, approval of the EDPR is appropriate as a legally-permissible formula rate of the type allowed pursuant to the

Commission's authority under the general ratemaking provisions of Chapter 62 of the General Statutes and as a "reward" under G.S. 62-2(a)(3a), subject to modification or elimination in either Docket No. E-7, Sub 831 or Docket No. E-100, Sub 113.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 23

Between August 14, 2007, and September 20, 2007, public hearings were held in Winston-Salem, Charlotte, Durham, Marion, and Franklin for the purpose of receiving public testimony.

Four customers testified at the public hearing held in Winston-Salem. Witness Kristie Reid, a residential customer, testified in opposition to the rate increase. Witness Robin Rhyne, a residential customer and the Economic Developer for Surry County testified that she supported the proposed rate increase if it were necessary to support the construction of more generation. Witness Larry Law testified on behalf of Lorillard Tobacco Company, a large industrial customer. Witness Law testified in support of rate parity between residential, commercial, and industrial customers but expressed concern regarding the lack of specifics provided in connection with the proposed Save-a-Watt program and the cost effectiveness of the Renewable Energy and Energy Efficiency Portfolio Standard (REPS). Witness Sandra Thomas, a residential customer, opposed the magnitude of the proposed rate increase.

Five customers testified at the public hearing held in Charlotte. Witness Jack Copeland, Jr., opposed Duke's proposal for different rate increases for residential customers and industrial customers. Witness James Howard testified on behalf of Pharr Yarns, an industrial customer. Witness Howard commented that the rates charged industrial customers should be significantly lower than the rates charged to other customer classes and, consequently, testified in support of Duke's proposed rate design. Witness Donny Hicks, President of North Carolina Economic Developers Association, testified in support of Duke's proposed rate increase. Witness Ron Smidt, Vice President of Facility Services for Carolinas Health Care System, testified in support of Duke's proposal to address rate of return discrepancies between residential and large commercial and industrial customers. Witness John Nims testified on behalf of Parkdale Mills and stated that, although he did not endorse or oppose the rate increase, he supported Duke's proposal to address the customer class rate parity issue.

Two customers testified at the public hearing in Durham. Witness Ted Conner, Vice President for Economic Development for the Greater Durham Chamber of Commerce, testified in support of Duke's request "to become more efficient in allocating power generation and distribution costs to their customers." Witness Bill Kalkaf, President and CEO of Downtown Durham, Incorporated, testified in support of Duke's proposed rate increase.

Four customers testified at the public hearing held in Marion. Witness Dave Hart, Vice President of Economic Development for the Cleveland County Chamber of Commerce, opined that the proposed increase was necessary, but requested that the cost of service be assigned fairly among the various customer classes. Witness Tony Young, Vice President of Manufacturing for the Meridian Specialty Yarn Group, testified in support of the proposed rate increase. Witness David Johnson, whose company markets and sells residential demand control systems within Duke's service territory, testified that Duke's current and proposed time-of-use rate fails to encourage energy efficiency by providing incentives to customers to either control demand or shift usage to off-peak hours. Witness Roxanne Boyd, a residential customer, stated that she believed the customer hearing might provide "some insight on why my power bill is so high" and, consequently, that is why she attended the hearing.

Six customers testified at the public hearing held in Franklin. Witness Verlin Curtis, Alderman for the Town of Franklin, testified in opposition to the proposed rate increase. Witness Dan Roland testified on behalf of Jackson Paper and expressed support for Duke's proposed rate increase. Witness Jan Unger testified on behalf of Zickgraf Enterprises and stated that the Company was supportive of the proposed rate increase to the extent such an increase more equitably allocated utility expenses among customer classes. Witness Roy Sargent stated that Duke had "trimmed the customer service"; commented that it currently takes longer to bring service back on line after an interruption than it did in 1991; and further noted that it takes longer to report a power outage than it used to. Witness Sargent requested that the Commission investigate the deterioration in the level of customer service in the Nantahala area prior to approving Duke's requested rate increase. Witness Sargent further requested that the Commission deny any portion of Duke's requested increase that would be used for business expansion. Witness Narelle Kirkland testified in opposition to the proposed rate increase. Witness David Johnson, who previously testified at the Marion public hearing, further commented that residential customers should receive virtually no rate increase or only a very small increase and that any increase should be applied to the heavier users.

On December 14, 2007, Duke filed a letter with the Commission setting forth Duke's response to the service quality issues presented by witness Roy Sargent at the public hearing held on September 20, 2007, in Franklin, North Carolina. In its letter, Duke stated that, after the public hearing, Duke's representatives discussed with witness Sargent his concerns relating to his attempt to report a power outage in the Nantahala area in July, 2007. Duke further stated that the Company conducted an investigation and determined that the telephone directories in the Nantahala area published an incorrect number for reporting power outages, which appeared to be the root cause of the problem witness Sargent experienced. By letter dated September 26, 2007, Duke informed witness Sargent about the results of the Company's investigation. This letter was filed with the Commission on December 14, 2007. According to Duke, witness Sargent has had no further communication with the Company regarding his concerns.

Consistent with Paragraph 18 of the Stipulation and the evidence of record, the Commission finds and concludes that the overall quality of electric utility service provided by Duke to its North Carolina retail customers is good.

EVIDENCE IN SUPPORT OF FINDINGS OF FACT AND CONCLUSIONS NOS. 27 - 30

These findings and conclusions are supported by the Stipulation, Duke's verified Application and Form E-1 Rate Case Information Report, the testimony and exhibits of the witnesses for the Company and the Public Staff, the testimony of DENR witness Brock Nicholson, and the entire record in this proceeding. These findings and conclusions are not contested by any party.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 31

This finding of fact and conclusion concerns the FASB's SFAS No. 158. It is supported by the Stipulation, Duke's verified Application and Form E-1 Rate Case Information Report, the testimony and exhibits of the witnesses for the Company and the Public Staff, Duke's late-filed exhibits and comments in response to the Commission's Post-Hearing Order, the Public Staff's comments in response to the Post-Hearing Order, and the entire record in this proceeding. In this regard, the Stipulation provides as follows:

> **8. SFAS 158 ISSUE.**
>
> A. In Docket No. E-100, Sub 112 the Company and the Public Staff differed as to whether the treatment of deferrals by Duke Energy Corporation, the parent of Duke Energy Carolinas, in compliance with SFAS 158, required Commission approval under N.C. Gen. Stat. § 62-133.6(e) and Commission Rule R8-27, and after consideration, the Commission concluded that an evidentiary hearing was required to determine that issue.
>
> B. The Stipulating Parties agree as follows with respect to that issue:
>
> (1) The Stipulating Parties recommend that the Commission approve Duke Energy Corporation's establishment of a regulatory asset (using Account 182.3) with respect to Duke Energy Carolinas' apportioned share of the funded status of Duke Energy Corporation's pension and other post retirement benefit plan obligations, as part of its compliance with SFAS 158.
>
> (2) Without conceding that approval is required by N.C. Gen. Stat. § 62-133.6(e) or Commission Rule R8-27, Duke Energy Corporation agrees, subject to Commission approval, to establish a regulatory asset (using Account 182.3) with respect to Duke Energy Carolinas' apportioned share of the funded status of Duke Energy Corporation's pension and other post-retirement benefit plan obligations, as part of its compliance with SFAS 158.

(3) Without conceding that approval is not required by N.C. Gen. Stat. § 62-133.6(e) or Commission Rule R8-27, the Public Staff agrees not to assert in this or any future proceeding that Duke Energy Corporation's establishment of this regulatory asset in itself affects Duke Energy Carolinas' rates or service so as to support a finding that Duke Energy Corporation is a public utility under N.C. Gen. Stat. § 62-3(23)c.

Thus, the Stipulating Parties have recommended that the Commission approve Duke Energy's establishment of a regulatory asset in Account No. 182.3 with respect to Duke's apportioned share of the funded status of pension and OPEB plan obligations as part of its compliance with SFAS No. 158. However, as discussed subsequently, the Commission has concluded that further examination, evaluation, and review of this issue are needed. Therefore, the Commission is of the opinion, and so finds and concludes, that Paragraph 8 of the Stipulation should be approved on a provisional basis pending completion of the Commission's further inquiry.

The issues which the Commission believes call for additional inquiry primarily involve pension costs and pension funding[3] from the standpoint of their impact and potential impact on rates. Specifically, the additional issues concern (1) the unsystematic manner in which Duke's pension obligations have been funded by Duke Energy and (2) the impact of these funding practices on the "regulatory asset" placed on Duke Energy's books as a result of application of SFAS No. 158.

In response to questions from the Commission, Duke witness Jacobs testified that Duke's obligations for pensions were underfunded by approximately $300 million on a total-company basis.[4] According to witness Jacobs, no contributions were made to Duke's pension fund in either 2005 or 2006, while the levels of pension costs charged to Duke's cost of service as operating revenue deductions and capitalized for those years appear to have been approximately $48.5 million[5] and $55.7 million,[6] respectively.

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[3] The Commission's concerns regarding OPEB costs and funding are more limited than its concerns regarding pension funding. That is due to the fact that OPEB obligations are funded internally and the fact that the OPEB fund balance is treated as cost-free capital in determining the Company's cost of service for ratemaking and earnings surveillance purposes; at least, the Commission understands that to be the case. However, as discussed elsewhere herein, the Commission is requesting that the Public Staff examine and evaluate certain specific issues which, in part, involve both pension and OPEB costing and funding.

[4] Witness Jacobs further testified that Duke's OPEB obligations were also underfunded, on a total-company basis, by approximately $300 million.

[5] See Duke's response to Question No. 5-4 (as identified by Duke), as set forth in its filing of November 1, 2007, in response to the Commission's Post-Hearing Order.

[6] This is an estimated amount based upon information presented in Duke's Late-Filed Exhibit No. 10, which was contained in its filing on October 26, 2007. This exhibit shows, among other things, that, for the 2006 test period, $44.5 million of pension expense was included as an operating revenue deduction on a total-company basis. In providing actual cost information for calendar years 1997 through 2005, Duke assumed that 80% of such costs were charged to expense and that 20% were capitalized. Making those same assumptions for the 2006 test period implies that total pension costs charged to expense and

Duke's North Carolina retail jurisdictional share of the $300 million in underfunded pension obligations is approximately $210 million.[7] Duke's North Carolina retail jurisdictional share of the pension costs charged to the cost of service as operating revenue deductions and capitalized in 2005 and 2006 are approximately $31.3 million[8] and $39 million,[9] respectively.

The Commission, in its Post-Hearing Order, requested that Duke provide certain additional information concerning this matter as a late-filed exhibit and that the parties brief certain additional issues. The additional issues were addressed by Duke and the Public Staff.

In its Supplemental Brief, Duke observed that its parent, Duke Energy, is responsible for funding the pension obligations of Duke and that Duke Energy's funding decisions and the timing of such decisions are based principally on (a) the funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and in the future, the Pension Protection Act,[10] when the applicable provisions of that law become effective; (b) the current expected funded status of the pension fund given those requirements; (c) the deductibility rules set forth in the Internal Revenue Code; and (d) the expected and actual returns on plan assets.

Duke noted that Duke Energy maintains separate plans for the pension benefits of legacy Duke Energy (including Duke) employees and legacy Cinergy Corp. employees and that the assets for each of its tax-qualified defined benefit retirement plans are held in a single Master Retirement Trust. According to Duke, a single trust allows Duke Energy to maximize administrative efficiencies and to achieve the lower money management fees that are available to larger pools of assets. Duke stated that Duke Energy keeps separate accounting records for each unique business unit, such as Duke.

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capitalized for that year were approximately $55.7 million. The Commission is mindful of the fact that the 2006 test-period level of pension expense may reflect a normalized level. However, any difference that may exist between the actual and normalized amounts of pension expense would not appear to be so material as to significantly alter the Commission's finding and conclusion that further examination and evaluation are needed in this regard.

[7] The allocation of these costs to the North Carolina retail jurisdiction is based upon a factor of 69.987%, which appears to be consistent with comparable allocations made by Duke.

[8] See Duke's response to Question No. 5-4 (as identified by Duke), as set forth in its filing of November 1, 2007, in response to the Commission's Post-Hearing Order.

[9] The allocation of this estimated amount is based upon a factor of 69.987%, which appears to be consistent with comparable allocations made by Duke.

[10] According to Duke, "[t]he Pension Protection Act of 2006, another federal law that imposes funding rules for pension plans, becomes effective January 1, 2008. This law makes the most significant changes to pension funding since the passage of ERISA in 1974. Among other things, it provides for the acceleration of cash funding, increased disclosure requirements, and restrictions on benefit improvements and payment of lump sums for under-funded plans."

Duke explained that plan assets are tracked in two separate steps. First, in accordance with ERISA, the assets for each of the plans, as well as the earnings on those assets, are accounted for separately and, at all times, each plan's asset balances are separately identifiable and are only available to pay benefits for participants in that plan. Second, for purposes of accounting, when pension fund contributions are made, the cost of the contributions is separately accounted for and allocated to the appropriate business unit, so that the cost of contributions with respect to Duke's employees, for example, are allocated to Duke.

Duke stated that pension funding obligations are fixed by ERISA and the Pension Protection Act, whereas the rules governing accounting for pension plans are established by the FASB. Therefore, according to Duke, a plan's "funded status" as determined under the accounting rules may indicate that the plan is underfunded although the same plan, under the applicable ERISA and Pension Protection Act funding rules, is, in fact, not underfunded using the tests required by those laws. Duke averred that these two sets of rules have different purposes: "[T]he ERISA rules are intended to ensure the protection and adequacy of funds to satisfy its pension obligation, whereas the accounting rules are intended to provide adequate and consistent disclosure to investors about the status of such funding."

Duke acknowledged that, "[i]t is correct, as the Commission notes, that the greater the level of earnings on pension plan assets, the lower the net cost of pensions includable in rates." However, Duke also noted that there are other factors that impact the performance of a company's pension fund and the determination of its funded status. Duke stated that some of those factors are wholly within a company's control and others are not.

In its Post-Hearing Order, the Commission requested that the parties address the following question:

> Should the Commission require, as a minimum, that all pension and OPEB net costs included in Duke's North Carolina retail rates be accrued and funded on an annual basis at the level included in rates based upon actual, annual kWh sales, or some other actual-sales basis, if more appropriate, and that such cost recovery be accounted for accordingly?

Regarding pensions, Duke responded that the Commission should not require the Company to accrue and fund such net costs on an annual basis at the level included in rates, stating that such systematic accrual and funding may not result in the best fund performance or lower rates to customers. Duke commented that accrual and funding based upon actual, annual kWh sales, or some other actual-sales basis, are not appropriate and may be inconsistent with ERISA's minimum funding requirements and the deductibility limits set forth in the Internal Revenue Code. Duke observed that its outside actuary, Hewitt Associates, LLC, estimates pension expense each year based on the accounting rules set out in SFAS No. 87, entitled "Employer's Accounting for Pensions," and that such expense varies from year to year. Accordingly, Duke contended that pension expense should be treated like any other operating expense that varies from year to year. Duke noted that, under North Carolina law, rates are to be established in general rate cases based on a test-period level of costs and that such rates are intended to enable the utility to recover its ongoing level of total costs and to provide a reasonable return for its investors. Duke stated that it was of the opinion that the representative level of pension costs it proposed, and which was implicitly agreed to by the parties to the Stipulation, is reasonable and appropriate for inclusion in its cost of service for purposes of this proceeding.

Duke explained that, because costs included in the cost of service do vary from year to year, the Commission has established procedures for Duke to report its North Carolina retail earnings on a quarterly basis. According to Duke, this Form ES-1 surveillance reporting requirement allows the Commission to review the financial performance of Duke and the overall reasonableness of its rates as established in general rate cases such as this proceeding. Duke submitted that an important cost element in this equation is the level of pension expense as determined under the provisions of SFAS No. 87. In conclusion, Duke stated that the level of pension costs included in rates has been rationally accrued and funded by Duke Energy and that Duke's ratepayers and employees have benefited from a careful, consistent approach that weighed all of the relevant economic, legal, and accounting factors.

In responding to the foregoing question posed by the Commission, the Public Staff stated as follows:

> As indicated by witness Maness at the October 17, 2007, hearing, whether the pension and OPEB costs included in Duke's North Carolina retail rates should be accrued and funded annually at the level included in rates on an actual-sales basis is a complex issue that would require further review before the Public Staff could formulate a position. Moreover, while deferrals may be appropriate for certain items, the Public Staff generally views the historical test period as a model or guide for determining a revenue requirement that will allow a utility the opportunity to recover its overall cost of service rather than as a basis for tracking specific categories and amounts of expenses, revenues, and rate base changes over time. This is the ratemaking approach taken in the Stipulation in this proceeding.

Additionally, the Public Staff, in its response to the Post-Hearing Order, stated as follows:

> It is reasonable to assume that, if the pension plan is not systematically funded, annual net periodic pension costs will be higher and the amount of the liability for those obligations will be larger.

To gain additional insight into Duke Energy's pension funding approach, the Commission performed a preliminary quantitative analysis employing certain simplifying assumptions. This analysis compares the impact of two different funding approaches and measures their effectiveness in terms of their comparative impacts on pension fund earnings and pension fund balances at the end of calendar year 2006. The analysis, which follows, is based upon the information contained in Table A below:

TABLE A

Statement of Annual Pension Costs Expensed and Capitalized and Amounts Contributed to Trust Fund - North Carolina Retail

For Calendar Years 1997 Through 2006
(Millions of Dollars)

Line No.	Year (a)	Amounts Expensed And Capitalized ($) (b)	Amounts Contributed To Trust Fund ($) (c)
1	1997	28.0	-
2	1998	26.7	-
3	1999	26.3	-
4	2000	15.8	-
5	2001	13.3	-
6	2002	7.0	-
7	2003	19.2	85.6
8	2004	20.9	121.0
9	2005	31.3	-
10	2006	39.0	-
11	Total	227.5	206.6

The information contained in Table A was taken, in large measure, from Duke's late-filed exhibits. The data presented reflect the annual amounts of pension costs expensed and capitalized and the annual amounts contributed to the pension trust fund during the period 1997 through 2006, on a North Carolina retail basis. Table A includes estimated data for calendar year 2006 in regard to the amount of pension costs expensed and capitalized for that year. Derivation of the 2006 data has been previously discussed.

As reflected in Table A, Line 11, Column (b), Duke, on a North Carolina retail basis, during the 10-year period 1997 through 2006, charged to expense and capitalized a total of approximately $227.5 million in pension costs. As shown on Line 11, Column (c), Duke Energy contributed a total of approximately $206.6 million to Duke's pension fund during this same period. Thus, during that 10-year period, Duke charged to expense and capitalized approximately $20.9 million more than Duke Energy contributed to Duke's pension fund.[11]

[11] In its response to the Commission's Post-Hearing Order, Duke noted that, "[a]s shown in the response to Question [No. 5-4], Duke Energy Corporation has contributed to the legacy Duke Energy Corporation pension plan an amount designated for Duke Energy Carolinas in excess of the pension cost charged to Duke Energy Carolinas." Duke noted that such excess contributions for the nine-year period, 1997 through 2005, addressed in Question No. 5-4, were $28 million. The North Carolina retail portion of that total-company amount is approximately $18 million. Duke's analysis does not take into account the pension cost charged to its cost of service and capitalized in 2006 and does not consider the time value of money, the importance of which is clearly significant. Such significance is discussed subsequently.

In evaluating the impacts of the activities summarized in Table A, the Commission is of the opinion that it is entirely appropriate to also consider the time value of money, that is, the earnings impact that, potentially, could have been realized on pension fund assets had the pension fund actually been funded on an annual basis at the same level as such costs were charged to expense and capitalized each year during the 10-year period. In performing that aspect of the analysis, the Commission utilized 7% as a proxy for the appropriate earnings rate.

Based upon the foregoing assumptions, it appears to the Commission that, if the amounts shown in column (b) of Table A had been invested annually, at the end of each calendar year, such that they would have earned a return of 7% compounded annually, the balance in the pension fund associated with that cash flow stream, on a North Carolina retail basis, would have been approximately $311.1 million at the end of 2006. If one were to make those same assumptions with regard to the actual funding levels shown in column (c) of Table A, the balance in the pension fund associated with that cash flow stream, on a North Carolina retail basis, would have been approximately $243.4 million at the end of 2006, or approximately $67.7 million less than the pension fund balance under the former approach.

Stated alternatively, based upon the assumptions noted above, had the pension fund been systematically funded on an annual basis at the same level as such costs were charged to expense and capitalized each year during the 10-year period from 1997 through 2006, as compared to the manner in which it was actually funded during those years, contributions to the pension fund would have increased by approximately $20.9 million and fund earnings would have been approximately $46.8 million higher.

The Commission is well aware of the fact, as indicated by Duke, that there are numerous factors that enter into Duke Energy's decisions regarding the funding of Duke's pension obligations. However, the Commission continues to be interested in whether the approach employed by Duke Energy for the 10-year period 1997 through 2006 produced as favorable a result for Duke's North Carolina retail ratepayers, from the standpoint of cost minimization, as, conceivably, could have been achieved under a more systematic approach. Consequently, the Commission determines that the Commission, the Company, and the Public Staff should study this issue further.

Additionally, based upon Duke's response to the Commission's Post-Hearing Order, the Commission is interested in determining whether the level and timing of pension costs actually expensed and capitalized by Duke on an annual basis are factors that enter directly into Duke Energy's decisions with respect to the funding of Duke's pension obligations. Further, the Commission would like to explore whether such factors should be considered in Duke's funding decisions, at least from the standpoint of ensuring that ratepayer interests are fully protected.

The Commission does not, in this context, question Duke's accounting or its assertion that ERISA rules and accounting rules, when considered independently, may produce different results from the standpoint of determining the funded status of pension obligations. Rather, the Commission's area of interest is whether Duke's North Carolina retail pension obligations, regardless of whether those obligations are determined under ERISA and/or accounting rules, are funded such that Duke's North Carolina retail ratepayers receive appropriate benefits to which they are entitled. Moreover, a better understanding of these issues will be relevant to the Commission's ultimate treatment of the regulatory asset that has been stipulated to, and approved on a provisional basis, in this docket.

According to Duke, the level of pension costs included in expense is determined based upon accounting rules, that is, according to SFAS No. 87. In any event, to the extent pension obligations are underfunded based on those rules, or for that matter under other rules, the potential exists for Duke to seek recovery of the unfunded amount through rates. In fact, generally speaking, that is the reason why, under accounting rules promulgated by the FASB and by this Commission, regulated enterprises are allowed to defer such costs as "Other Regulatory Assets."[12] Duke witness Jacobs'

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[12] SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit pension or other postretirement plan, measured as the difference between plan assets at fair value and the benefit obligation, as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which changes occur through accumulated other comprehensive income. SFAS No. 158 also requires entities to recognize as a component of accumulated other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost of the period pursuant to SFAS No. 87 and SFAS No. 106, entitled "Employers' Accounting for Postretirement Benefits Other Than Pensions."

With respect to the financial statements of an enterprise that has regulated operations that meet certain criteria, such enterprises are required to account for the effects of regulation under the provisions of the FASB's SFAS No. 71 "Accounting for the Effects of Certain Types of Regulation." Among other things, SFAS No. 71 provides as follows:

> An enterprise shall capitalize all or part of an incurred cost [footnote omitted] that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable [footnote omitted] that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

Furthermore, the Commission, as set forth in Commission Rule R8-27, has adopted, as its accounting rules for jurisdictional electric utilities the Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act, as currently embodied in the United States Code of Federal Regulations, Title 18, Part 101 (USOA), subject to certain exceptions and conditions. This USOA had been previously adopted for use by the Federal Energy Regulatory Commission (FERC), or more precisely, the FERC's predecessor, the Federal Power Commission.

Among other things, Rule R8-27 provides that ". . . electric utilities under the jurisdiction of the Commission must apply to the Commission for any North Carolina retail jurisdictional use of . . . Account 182.3 – Other Regulatory Assets [and] Account 254 – Other Regulatory Liabilities." The USOA defines regulatory assets and liabilities as follows:

testified that, to the extent pension funding shortfalls identified under accounting rules materialize, Duke would seek recovery of those costs through rates:

> MR. JACOBS: I think we would try to have customers pay for their fair share of the cost of our employees.

Because of the materiality[13] and complexity of this issue, the Commission is of the opinion, and so finds and concludes, that the entire matter of pension and OPEB costing and funding from the standpoint of their impact and potential impact on rates should be further examined and evaluated, including examination and evaluation of the interrelationship, if any, that may exist between (a) the amounts of pension and OPEB costs included in the test-period cost of service; (b) the amounts of pension and OPEB costs actually charged to expense and capitalized annually; and (c) the amount of funding actually contributed to the pension trust fund on an annual basis.

In conclusion, based upon the foregoing and the entire evidence of record, the Commission finds and concludes that (a) Duke Energy's establishment of a regulatory asset in Account No. 182.3 with respect to Duke's apportioned share of the funded status of pension and OPEB plan obligations as part of its compliance with SFAS No. 158 should be approved on a provisional basis, pending completion of the Commission's further review of this matter as provided for herein, and that (b) the Public Staff should be requested to undertake a comprehensive examination and evaluation of Duke's and Duke Energy's practices with respect to the costing and funding of Duke's pension and OPEB obligations and to file a detailed report with the Commission setting forth its findings, conclusions, and recommendations. The Commission further finds and concludes that the Public Staff should be specifically requested to include the following issues in the scope of its examination and take a position with respect to such issues:

1. Is the approach historically employed by Duke Energy in funding Duke's pension obligations economically efficient and otherwise appropriate from the standpoint of ensuring that North Carolina retail ratepayer interests are fully considered

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> 30. *Regulatory Assets and Liabilities* are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable:
>
> A. that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or
>
> B. in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.

[13] As previously noted, based on information contained in Duke's November 1, 2007 filing, which was made in response to the Commission's Post-Hearing Order, the total amount of the regulatory asset recorded on Duke Energy's books attributable to Duke, at December 31, 2006, was $550.7 million on a total-company basis. On a North Carolina retail basis, such amount was $385.4 million.

and protected and, if so or if not, why, and what remedy, if any, would the Public Staff recommend that the Commission consider ordering?

2. Should the Commission, for jurisdictional accounting, ratemaking, and reporting purposes prescribe a specific methodology to be followed by Duke for purposes of determining the appropriate amounts of costs to be assigned and/or allocated to Duke's North Carolina retail operations with respect to its pension and OPEB obligations and, if not, why, and if so, why, and what methodology would the Public Staff recommend that the Commission consider adopting?

3. What additional measures, if any, should the Commission implement in this regard? For example, should the Commission require follow-up reports and, if so, how often and what information should the reports contain?

4. Have Duke's North Carolina retail operations been negatively impacted, or could they be so impacted prospectively, in any way, as a result of the accounting entries entered on the books of Duke Energy associated with its application of the provisions of SFAS No. 158 (for example, due to (a) the recording of a regulatory asset on the books of Duke Energy, (b) the amount of the asset so recorded, (c) the transfer/reclassification of funds from pre-funded pension and OPEB accounts to other accounts, etc.) and, if so or if not, why, and what remedy, if any, would the Public Staff recommend that the Commission consider ordering?

Should the Public Staff, as a party to and with obligations under the Stipulation, determine that it is, in some way, constrained in its ability to undertake this examination and evaluation,[14] it should so advise the Commission by means of an appropriate filing. Otherwise, the Public Staff shall undertake the requested examination and evaluation on behalf of the Commission and is hereby authorized, in its discretion and as it deems advisable and necessary, to engage an independent accounting or consulting firm to either conduct the present examination and evaluation or, in the alternative, provide consulting assistance to the Public Staff.

Finally, the Commission is of the opinion, and so finds and concludes, that the Commission Staff should meet and confer with the Public Staff and Duke for the purpose of assisting in the administrative process as well as in defining the specific scope of this examination and evaluation of Duke's pension and OPEB plan funding practices.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 32

This finding of fact and conclusion is supported by the Stipulation and the testimony and exhibits of Duke witness Horsley and Liberty witness Antonuk. The Commission finds and concludes that all matters related to Liberty's final audit report, filed on October 1, 2007, should be bifurcated from this proceeding and will be addressed by the Commission by further Order.

[14] The Commission infers no criticism of the Public Staff by this statement. A conflict, if any exists, would result from the Public Staff's position as a Stipulating Party and the actions being requested of it by the Commission.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 33

The evidence supporting this finding of fact and conclusion is contained in the testimony and exhibits of Duke witnesses Shrum and Ruff and Public Staff witness Peedin.

Duke witness Shrum testified in support of three pro forma adjustments to test period cost of service, as shown on Shrum Exhibit 1, Page 3, Lines 1-3, that were intended to remove the effects of the Duke Energy/Cinergy Corp. merger from the Company's North Carolina retail rates. The first adjustment increased test-period revenues by $56.5 million to eliminate the effect of the revenue decrement rider in place during the test period for the purpose of sharing 42% of the estimated five-year net merger savings with North Carolina retail customers. The second adjustment increased test-period costs by $39.9 million to eliminate the actual gross savings experienced in 2006 as a result of the merger. The third adjustment decreased test-period costs by $57.3 million to eliminate from cost of service the actual costs incurred in 2006 to achieve merger savings. Company witness Ruff testified that it was necessary to present the test-period cost of service as though the merger had not taken place, because, in compliance with the Merger Order, customers have already received their full share of the five-year net merger savings through a guaranteed up-front payment.

Public Staff witness Peedin testified that the $39.9 million by which Duke adjusted its O&M expenses is the equivalent of nine months of gross Year 1 savings as calculated in the cost-benefit study filed by the Company in the Merger Docket. Witness Peedin testified that this adjustment, in effect, reduces the amount of savings to be received by the Company's ratepayers on a going-forward basis and allows the Company's shareholders to receive the benefit of those savings.

Witness Peedin further testified that the appropriateness of the adjustment depends upon the interpretation of Regulatory Condition No. 76 of the Merger Order. Witness Peedin asserted that the Company's adjustment is inconsistent with the Commission's stated intention in its discussion of this condition in the Merger Order, which provides that customers should "receive the actual achieved benefits of Duke Power's post merger operations to the maximum extent possible."

The first part of Regulatory Condition No. 76 required the rate case filing that is the subject of this proceeding. The part giving rise to the disagreement between Duke and the Public Staff is as follows:

> To the extent the $117,517,000 one-year rate decrement flowed through by Duke Power to its North Carolina retail customers is deferred, with plans or provisions for amortization over future periods pursuant to Regulatory Condition No. 25, <u>no portion of such amount, including amortization thereof, will be eligible for recovery as a component of Duke Power's North Carolina retail rates</u> set prospectively following consummation of the Merger. In particular, <u>no allowance for same will be included in the test-year cost of service</u> developed for purposes of the general rate case proceeding to be instituted pursuant to this Regulatory

Condition; nor will any portion of such amount be recoverable from Duke Power's North Carolina retail ratepayers by means of a rate rider or otherwise. Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. (Emphasis added.)

According to witness Peedin, the Public Staff believes that, when interpreted in conjunction with the discussion in the Merger Order, Regulatory Condition No. 76 requires that no adjustment be made in the rate case to account for either the one-year rate decrement approved in the Merger Order or for the savings Duke Energy Corporation attributed to its shareholders in that proceeding. Peedin Exhibit I, Schedule 1, reflects the reversal of the adjustment shown on Shrum Exhibit 1, Line 3.

Witness Peedin further testified that, to reflect a full year of merger savings in this case, it was necessary to annualize the $39.9 million amount of merger savings. The annualized amount of merger savings is shown on Peedin Exhibit I, Schedule 2, Line 1. The Public Staff then reduced this total annualized amount of $53.2 million by fuel savings of $6.9 million.[15] The effect of witness Peedin's adjustments was to reduce the Company's test-year O&M expenses by a total of $46.2 million and its revenue requirement by a total of $47.8 million.

On cross-examination, Public Staff witness Peedin was asked to accept some numbers on an exhibit identified as Duke Peedin Cross-Examination Exhibit No. 1. This document purported to show that the difference between the Company's position and the Public Staff's position is the difference between net savings of $163 million and net savings of negative $269 million. Witness Peedin, however, did not accept the numbers shown on the document and responded that the gross savings in the test year are embedded in the Company's cost of service and that it appears the Company is trying to increase expenses by $39.9 million to take back the savings that have already been flowed through to customers. In addition, when asked on cross-examination if she considered the Company's pro forma adjustment to be an attempt by the Company to take back part of the $117.5 million that it had already flowed through to customers through the one-year decrement rider, witness Peedin answered that she did.

In her rebuttal testimony, Duke witness Ruff stated that, if the Commission accepted the Public Staff's position to reverse the Company's adjustment to increase O&M expenses, it would leave the Company with all the costs to achieve and no ability to share in the merger savings, causing the Company and its shareholders to see a net loss of $269.5 million ($152 million + $117.5 million). Witness Ruff also contended that setting rates in this case to provide the full benefits of the $432 million in gross savings from the merger, plus the $117.5 million decrement, would provide the customers a windfall.

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[15] Regulatory Condition No. 73 provides that "any fuel related savings associated with the Merger shall be flowed through to Duke Power's North Carolina retail customers pursuant to G.S. 62-133.2." As shown in Public Staff Ruff Cross-Examination Exhibit No. 1, the estimated North Carolina retail merger savings included $4.9 million in fuel savings.

Company witness Ruff agreed that the proper treatment of the merger savings is addressed in Regulatory Condition No. 76, but she differed with the Public Staff's interpretation of that Condition. She testified that Regulatory Condition No. 76 should not be read in isolation from the other Regulatory Conditions of the Merger Order. In particular, witness Ruff pointed to Regulatory Condition No. 73, which provides a one-year decrement rider by which $117.5 million, which is 42% of the North Carolina retail portion of the projected five-year net merger savings, would be shared with the Company's North Carolina retail customers. She also pointed to Regulatory Condition No. 74, which is a "Most Favored Nation" provision that assures that North Carolina retail customers do as well as customers in other Duke Energy Corporation jurisdictions "with regard to the sharing of net merger savings." These provisions make no sense, she said, if, as the Public Staff contends, virtually all of the gross merger savings must go to customers after the Company had already shared 42% of the net merger savings with them. As stated in the Company's Response No. 8-4 to the Commission's October 26, 2007 Post-Hearing Order, Duke contends that the Public Staff's proposal fails to consider the $117.5 million that has already been paid to customers in the form of a decrement rider. The annual allocation of $46.2 million of merger savings to customers would result in an additional $150.3 million of benefits to customers and, when combined with the $117.5 million already received, would mean that customers would receive a cumulative benefit of $267.8 million over 5 years. If the Public Staff's position were to be adopted, it would be impossible for the Company's shareholders to achieve their share of the net savings accepted in the Merger Order. The Public Staff position would result in customers receiving 97% of the net savings over the five-year period, while shareholders only received 3%.

Turning to Regulatory Condition No. 76 itself, witness Ruff testified that Regulatory Condition No. 76 relates to the $117.5 million that was to be shared with customers through the rider. While witness Ruff pointed out that the Company did not account for the financial effect of the rider by deferral, as Regulatory Condition No. 25 permitted, but instead recorded its effects as they occurred, the Company's test-period cost of service does not include any of the revenue-reducing effect of the rider. (In Shrum Exhibit 1, Page 3, Line 1 this effect is removed by a revenue add-back of $56.5 million, which is the portion of the rider that flowed through in the test period.) Thus, witness Ruff contended that the Company has complied with both the spirit and letter of the Condition. In addition, witness Ruff testified that the Public Staff's interpretation would not only be patently unfair, and constitute a retreat from the sharing arrangement that was basic to the Merger Order, it would also "communicate the unfortunate message that North Carolina is not receptive to business combinations by the utilities it regulates."

Witness Ruff further testified that this rate proceeding was not intended to provide a forum for either advocating an undoing of the equitable division of risks and rewards in the Merger Order or providing a windfall, at shareholders' expense, to customers. She contended that the Public Staff's reading of Regulatory Condition No. 76 "not only produces a grossly unfair result, but it is also at cross purposes with other Regulatory Conditions." According to witness Ruff, if the Commission intended customers to receive 100% of the merger savings, then Regulatory Condition No. 73, which provides a sharing of 42% with customers, and Regulatory Condition No. 74, which is the "Most Favored

Nation" clause, would be superfluous. Finally, witness Ruff stated that it was inconceivable to her that the Company would be required to bear all of the costs of achieving the merger savings in addition to the other costs and risks associated with the merger without having any opportunity to share in the benefits.

On cross-examination, Duke witness Ruff conceded that the fuel savings number in Public Staff Ruff Cross-Examination Exhibit No. 3 is a part of the Year 1 annualized amount of $55 million, and that the $39.9 million pro forma adjustment made by witness Shrum to increase operating expenses included fuel savings that the Commission ordered to be flowed through the fuel adjustment mechanism. Witness Ruff also agreed that, under North Carolina ratemaking procedures, future savings (i.e., the full benefit of $432 million in gross savings shown on Public Staff Ruff Cross-Examination Exhibit No. 1 and Attachment C to the Stipulation in the Merger Docket) would not be reflected in the test year for this case.

In its Post-Hearing Brief, Duke presented in more detail the Company's position that the internal evidence in the Merger Order shows that the Company's intent was to offer, and the Commission's intent was to approve, a "sharing" of 42% of the estimated five-year merger savings. In its Finding of Fact No. 11 the Commission stated that

> The primary quantifiable benefit of the Merger to ratepayers consists of the estimated merger savings . . . . Duke Power proposes to share 42% ($117,517,000) of the five year estimated net merger savings amount . . . assignable to its North Carolina retail customers.

The Company argued that, if, as the Public Staff proposed, customers were also to receive the additional benefit of the actual gross merger savings, that statement from the Merger Order was not true. Also, the Company argued, in its discussion of the evidence supporting its Finding of Fact No. 13, that the Commission said, in Footnote No. 31, that

> [T]he one year rate decrement in the amount of $117,517,000 ordered by the Commission is equivalent and equal to the exact dollar amount offered by the Company based upon its proposal to share 42% of the Company's five year estimated net merger savings assignable to its North Carolina retail ratepayers.

The Company also pointed to Page 73 of the Merger Order, where the Commission noted that the $117,517,000 decrement ordered by the Commission, rather than the $112,517,000 proposed by the Public Staff, was necessary to assure that North Carolina retail customers "in fact receive the full benefit of the exact 'sharing' required by the Duke Energy and Public Staff proposed Regulatory Condition No. 73, i.e., $117,517,000." Finally, the Company argued that the Commission on Pages 74-75 of the Merger Order found significance in the fact that the 42% sharing of the first five years of projected net merger savings was consistent with the level of sharing ordered in other jurisdictions and that it would not trigger the Most Favored Nation clauses in the orders entered in those jurisdictions. Additionally, in its Order Approving Fuel Charge Adjustment issued on April 27, 2006, in Docket No. E-7, Sub 805, the Commission noted that the merger decrement for the purpose of sharing merger savings began at the same time as the new fuel rider.

Duke further argued that, through the pro forma adjustments that it has made with respect to merger savings, it has complied with both the letter and spirit of Regulatory Condition No. 76. First, it has increased test-period revenues by $56.5 million to remove the revenue-reducing effect of the portion of the $117.5 million one-year decrement returned during the test period. This complies with the spirit of the first two sentences of the relevant portion of the Condition quoted above, although the Company chose not to defer the effect of the rider. Second, the Company's test-period cost of service contains no attempt to recover any shortfall of the shareholders' portion of the net merger savings, and this complies with the third sentence of the quoted language. Finally, by reducing test-period expenses to remove both the merger savings and the costs-to-achieve experienced in the test period, the Company has preserved the intent of the Merger Order as a whole, that is, that the customers receive 42% and the shareholders 58% of the projected five-year net merger savings.

The proper interpretation of Regulatory Condition No. 76 of the Merger Order underlies the disagreement between the Public Staff and the Company. The Company believes that, because the $117,517,000 one-year rate decrement was not "deferred, with plans or provisions for amortization over future periods pursuant to Regulatory Condition No. 25," the remaining provisions of Regulatory Condition No. 76 do not apply in this case. The Public Staff, on the other hand, believes that the language prohibiting an allowance for the rate decrement in cost of service and excluding any portion of the decrement or any portion of the net merger savings attributable to shareholders from recovery in base rates, when interpreted in light of language elsewhere in the Order and the Commission's intent to maximize the benefits of the merger to the Company's ratepayers, means that all of the savings reflected in the test-year cost of service should flow through to ratepayers.

The Commission agrees with the Public Staff's interpretation of the Merger Order and Regulatory Condition No. 76 and will, for that reason, disallow Duke's proposed adjustment to increase test-year operating expenses by $39,925,000 to eliminate gross merger savings which were actually experienced during the last nine months of the test year and will, instead, approve the Public Staff's proposed adjustment to test-year operating expenses to reflect an annualized level of merger savings minus fuel savings in the amount of $46,241,000. Longstanding general principles of ratemaking support rejection of the Company's proposed test-period adjustment to increase the cost of service by $39.9 million. The effect of Duke's proposal is to remove the gross merger savings which the Company actually achieved during the test period from cost of service. Such an adjustment is contrary to the traditional principles of ratemaking because rates in a general rate case should be designed to recover the utility's reasonable and prudent level of ongoing expenses. In this case, Duke's own evidence indicates that the Company actually achieved gross merger savings during the test year of $39.9 million and that the Company expects to achieve even greater levels of gross merger savings in the future. In fact, such savings will extend indefinitely beyond the five-year period of time reflected in the Company's cost benefit analysis as provided in the Merger Docket. To exclude these savings from Duke's cost of service in this case would clearly violate general principles of ratemaking established by Chapter 62 of the General Statutes. Simply stated, Duke's annual cost of service and revenue requirement should reflect, as closely as possible, the Company's actual costs of providing electric utility service to its customers, adjusted for known and certain changes in conditions occurring through the end of the hearing. Achieved test-period gross merger savings are clearly factors that affect the test-period cost of service and, as such, should be reflected in rates in this proceeding. Duke's shareholders will retain any gross savings above the first $46.2 million that occur each year until new rates are established in the Company's next general rate case. That result is fair to consumers and the Company.

Notwithstanding this conclusion, the Commission will, pursuant to G.S. 62-80, reconsider one provision of the Merger Order entered in Docket No. E-7, Sub 795 on March 24, 2006. The Commission will specifically reconsider that provision in Regulatory Condition No. 76 (as discussed in conjunction with Finding of Fact No. 37 in the Merger Order and the Evidence and Conclusions in support thereof) which provides that:

> . . . Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. . . .

Based on the evidence offered in these proceedings, the Commission has preliminarily concluded that the provisions of the Merger Order, as applied here, will not produce a fair sharing of the benefits of estimated merger savings between ratepayers and shareholders and, for that reason, Duke should be authorized to implement a 12-month uniform rate increment rider to collect $80,459,000 from its North Carolina retail customers for the benefit of its shareholders.[16] This amount represents 58% of the annualized level of gross merger savings of $46,241,000 reflected in rates in this proceeding for the next three calendar years (2008, 2009, and 2010); i.e., $46,241,000 gross merger savings per year, times 0.58, times 3 years, equals $80,459,000.

As an integral part of this general rate case proceeding, the Commission has carefully reviewed the provisions of the Merger Order, which govern how the benefits of the merger savings will be allocated between ratepayers and shareholders. The Merger Order was entered prior to consummation of the merger, when it was unclear whether, if consummated, the merger would result in any savings. As a result, the Commission's order was an effort to protect ratepayers from potential harmful consequences and fairly apportion potential prospective benefits. In resolving the merger savings issue in this docket, the Commission has the advantage of taking into consideration post-merger actual experience and, thus, is in a superior position to weigh the factors that must be addressed in fairly apportioning the benefits of the merger. The Commission's review has led the Commission to preliminarily conclude that, in retrospect, Duke's shareholders will not receive a fair allocation or share of the five-year estimated merger savings in light of the

[16] Similarly, the merger savings sharing rate decrement in the amount of $117.5 million approved by the Commission in Docket No. E-7, Sub 795 was also implemented on a uniform, across-the-board basis for 12 months.

current provisions of the Merger Order and applicable Regulatory Conditions. In the absence of a ratemaking adjustment such as the 12-month uniform rate increment rider discussed above, the benefits of the estimated gross merger savings will be divided between ratepayers and shareholders as follows:

Item	Amount
Costs-to-Achieve Merger	$152.5 million
Ratepayer Benefit	256.1 million[17]
Shareholder Benefit	23.8 million
Gross Savings	$432.4 million

Based on this analysis, the Commission tentatively concludes that Duke's shareholders should be allowed a greater share of the estimated benefits resulting from the merger. For that reason, the Commission has preliminarily concluded that Duke should be allowed to implement the 12-month rate increment in the amount of $80,459,000 discussed above. If that is done, the benefits of the estimated gross merger savings will then be divided between ratepayers and shareholders as follows:

Item	Amount
Costs-to-Achieve Merger	$152.5 million
Ratepayer Benefit	175.6 million[18]
Shareholder Benefit	104.3 million[19]
Gross Savings	$432.4 million

While any such apportionment requires an exercise in judgment, the Commission is of the opinion that this result fairly balances the interests of both consumers and shareholders and will result in both groups receiving a more fair and equitable allocation of the estimated merger savings than would be the case if the relevant provisions of the Merger Order were left intact and strictly applied. The Commission is convinced that the tenets of fair and reasonable regulatory policy, sound public policy, and fundamental fairness support reconsideration and suggest that Duke's shareholders, considering their support for the merger and their assumption of significant costs and risks in conjunction therewith, should receive the benefit of additional merger savings. The Commission concludes that the steps the Commission has and is taking adequately protect ratepayers from risks of the merger, fairly apportion merger benefits, and demonstrate the Commission's desire to avoid discouraging business combinations that, over the long term, lower costs that ratepayers must bear. This result will also be more consistent with

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[17] The total ratepayer benefit of $256.1 million includes the $117.5 million rate decrement and the cumulative three-year total of the test-year gross savings amount of $46.2 million, which will be reflected in rates during calendar years 2008, 2009, and 2010.

[18] The total ratepayer benefit of $175.6 million includes the $117.5 million rate decrement and the cumulative three-year total of the test-year gross savings amount of $46.2 million, which will be reflected in rates during calendar years 2008, 2009, and 2010 minus the $80.5 million surcharge which the Commission is herein proposing to collect from ratepayers for the benefit of Duke's shareholders.

[19] The total shareholder benefit of $104.3 million includes the $80.5 million surcharge, which the Commission is herein proposing to collect from ratepayers.

the intent of the Stipulation and Agreement signed by Duke and the Public Staff in the Merger Docket than would be the case if the Commission were to strictly apply the provisions of the original Merger Order in this proceeding. Thus, the Commission has determined to reconsider the Merger Order.

As required by G.S. 62-80, parties will be given notice and opportunity to be heard in response to the Commission's stated intent to reconsider the specified provision of the Merger Order. However, the Commission does not intend to otherwise reconsider the Merger Order and will not entertain requests to do so. Initial comments on this matter on reconsideration should be filed by all parties not later than Friday, January 11, 2008, and reply comments should be filed not later than Friday, January 25, 2008. The Commission will then enter an Order on reconsideration after completing its review of those filings.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 34

The evidence supporting this finding of fact and conclusion is contained in the testimony and exhibits of Duke witnesses Shrum and Wright, Public Staff witness Maness, and the late-filed exhibits submitted by the Company at the request of the Commission. The Commission has also taken judicial notice of the record and Orders issued in Docket No. E-7, Sub 690.

Duke witness Shrum testified that the Company included in operating revenue deductions a five-year amortization of the costs it incurred in attempting to comply with Order No. 2000 and related Orders issued by the Federal Energy Regulatory Commission (FERC). These Orders required the Company to file a plan to form or join a Regional Transmission Organization (RTO) or explain why that action could not be accomplished. Witness Shrum testified that, in response to the directives of the FERC, the Company, along with Progress Energy Carolinas, Inc. (PEC) [formerly known as Carolina Power and Light Company (CP&L)] and South Carolina Electric & Gas (SCE&G), formulated plans to establish GridSouth Transco LLC (GridSouth) as an RTO that would assume functional control of the three utilities' transmission systems. During the "final development stages of GridSouth," however, the FERC's policy regarding RTOs shifted dramatically, causing the three utilities (referred to collectively as the GridSouth participants) to initially suspend and ultimately abandon the project.

Witness Shrum testified that these costs relate to "building and implementation costs associated with the development of GridSouth" and that, if the Company had ultimately been required by the FERC to join an RTO, these costs would have been included in the transmission fee charged by the RTO to the Company, and thus would have been eligible for inclusion in retail cost of service. She also testified that deferral of these costs had been allowed by the FERC in an Order issued January 25, 2001, in FERC Docket No. EL01-13-000. Witness Shrum asserted that these costs are "a necessary part of utility operations and are used and useful in providing electric service," both because the Company incurred them in response to the FERC's Orders and directives with which it was required to comply and because the operation of GridSouth would have benefited both retail and wholesale customers.

A review of Duke's Form E-1 Rate Case Information Report, Item 10, Pages ND-2300 through ND-2303, and the late-filed exhibits filed by the Company at the request of the Commission, shows that the total system amount of GridSouth costs deferred on the Company's books at March 31, 2007, was $58,444,000, consisting of a principal amount of $41,254,000 and accrued carrying charges of $17,191,000. The Company estimated that an additional $3,930,000 of carrying charges would be accrued during the remainder of 2007, resulting in the total amount of $62,374,000 for which the Company requested a five-year amortization. This $62,374,000 has been allocated by the Company as follows: $43,936,000 to the North Carolina retail jurisdiction, $15,612,000 to the South Carolina retail jurisdiction, and $2,826,000 to the wholesale jurisdiction. The Company's proposed North Carolina retail amortization of $8,787,000 was determined by dividing $43,936,000 by five years. As of June 2002, the Company had incurred $41,254,000 of GridSouth costs. North Carolina's jurisdictional share at that time was $29,059,000.

Public Staff witness Maness and Company witness Wright each presented testimony describing the development of GridSouth. Most of this evidence is not in dispute and is summarized below.

The process which led to the FERC's encouragement of RTO formation had its roots in the 1970s, when non-utility owned electric generating facilities began to be developed as a result of a number of circumstances, including the passage of the Public Utility Regulatory Policies Act of 1978. In an effort to promote greater competition in wholesale power markets, Congress subsequently adopted the Energy Policy Act of 1992 (EPAct 1992). Following the enactment of EPAct 1992, the FERC embraced the idea that a more definitive open access transmission paradigm than had previously existed was required to facilitate effective wholesale competition and introduced the idea of Regional Transmission Groups in a 1993 policy statement. Subsequently, in April of 1996, the FERC adopted Order Nos. 888 and 889 for the purpose of encouraging wholesale competition by requiring the provision of open access transmission service in the wholesale bulk power marketplace.

Company witness Wright testified that, on December 20, 1999, the FERC issued Order No. 2000, which required utilities regulated by the FERC to undertake to join or form an RTO that would be operational by December 31, 2001, or to provide an explanation as to why this could not be accomplished. Witness Wright testified that the GridSouth participants submitted their compliance filing to the FERC on October 16, 2000. That filing described the proposed structure and operations of GridSouth. Pursuant to that filing, the GridSouth participants were to retain system expansion planning responsibility for the Carolinas, the native load preference would be preserved, and the North Carolina and South Carolina Commissions would retain jurisdiction over all aspects of retail electric service, including the transmission component of retail rates.

Public Staff witness Maness testified that the GridSouth participants noted in their compliance filing that, due to the fact that retail rates remained regulated and bundled in North Carolina and South Carolina, they did not plan to transfer ownership of their transmission assets to GridSouth at that time; instead, they planned only to transfer functional control. Additionally, they noted that the proposed GridSouth Transmission Operating Agreement provided that the transmission component of bundled retail service would not be subject to transmission charges under the GridSouth Open Access Transmission Tariff (OATT). In other words, none of the GridSouth participants planned to separately purchase transmission service for their retail customers pursuant to the OATT, but would, instead, continue to recover costs of transmission from these customers as part of their bundled retail rates.

On November 3, 2000, the GridSouth participants filed with the FERC a request for a Declaratory Order seeking approval of their proposed accounting treatment for GridSouth costs. The FERC addressed that request in Carolina Power and Light Co., et al., 94 FERC ¶ 61,080, on January 25, 2001. According to witness Wright, the FERC allowed the GridSouth participants to treat their ongoing investment in GridSouth as deferred debits and to accumulate carrying costs on these amounts in that Declaratory Order. Public Staff witness Maness added that, because GridSouth was not yet operational, the FERC required the GridSouth participants to record the amount that would eventually become a receivable in Account 186 – Miscellaneous Deferred Debits. The FERC stated that acceptance of the petition, as modified, did not amount to pre-approval of rate recovery. The Declaratory Order also allowed GridSouth to defer the recovery of start-up costs until it became operational.

Company witness Wright also testified that, in order to meet the FERC's deadlines, the GridSouth participants worked to make GridSouth an operating entity from the autumn of 2000 until the spring of 2002. Land was procured and a facility was constructed in Fort Mill, South Carolina. Operating systems and related hardware, some staffing, software, other system supports, and the related design and installation of these systems, were contracted for and obtained. The GridSouth participants established budgets and worked to control costs in several ways. For example, Requests for Proposals were issued for a variety of the systems necessary to support GridSouth. Also, a management committee comprised of one executive from each participating company oversaw major financial decisions, reviewed project team recommendations, and in general worked to control project costs.

Public Staff witness Maness noted that, on March 14, 2001, the FERC issued an Order provisionally granting RTO status to GridSouth, finding that the proposal, as modified by the FERC in the Order, would create an RTO that would be in compliance with Order No. 2000. The FERC found GridSouth to be a "good first step," but strongly encouraged GridSouth to expand its footprint within the Southeast. In a May 30, 2001 Order clarifying certain points made in the March 14, 2001 Order, the FERC explicitly confirmed that the GridSouth participants would be required to pay GridSouth for retail transmission service, even if such payments were equal to the transmission component of their bundled retail rates.

On April 2, 2001, Duke and CP&L filed a Joint Application with the Commission in Docket Nos. E-7, Sub 690 and E-2, Sub 781 seeking authorization to transfer functional control of their transmission assets to GridSouth.

Company witness Wright testified that the FERC issued two relevant Orders on July 12, 2001. In an Order issued in the GridSouth docket, the FERC expressed concern about the independence of GridSouth from the GridSouth participants. The FERC also announced that it considered it necessary for a single Southeast RTO to be established. As a result, the FERC reversed several approvals it had granted in its March 14, 2001, Order. In the second Order, the FERC initiated a mediation proceeding intended to result in the formation of one RTO for the entire Southeast.

Public Staff witness Maness noted that, in August 2001, the Commission filed a request for rehearing and a motion for a partial stay in the FERC GridSouth and mediation dockets, arguing that the functions that the FERC had ordered to be turned over to GridSouth were integral components of retail service and that any such transfer interfered with legitimate State regulation and was, therefore, unlawful. Company witness Wright added that the Commission stated that the FERC was "asserting jurisdiction far beyond its statutory authority" and that the FERC "erred by concluding that a single RTO for the Southeast is in the public interest." In its motion to join in the appeal of the FERC's March 14, 2001, Order granting provisional RTO status to GridSouth, the Commission stated that the FERC's Orders in the GridSouth proceeding infringed upon the Commission's retail ratemaking and transmission planning authority, and thus exceeded the FERC's jurisdiction under the Federal Power Act.

On August 17, 2001, the Commission issued an Order in Docket No. E-7, Sub 690 holding Duke's and CP&L's GridSouth Joint Application in abeyance. In doing so, the Commission stated as follows:

> On July 12, 2001, the Federal Energy Regulatory Commission (FERC) issued a series of orders concerning regional transmission organizations (RTOs), including GridSouth. In its orders in Docket Nos. RT01-100 and RT01-74, the FERC concluded that it is necessary that the Southeastern transmission owners combine to form one RTO and initiated mediation for the purpose of facilitating the formation of a single RTO for the region. The FERC directed an administrative law judge to convene a meeting of the parties, to mediate settlement discussions for a period of forty-five days, and to file a report within ten days thereafter 'which will include an outline of the proposal to create a single Southeastern RTO, milestones for the completion of intermediate steps, and a deadline for submitting a joint proposal.'
>
> In light of the FERC's recent action and the uncertainty surrounding the structure and design of the RTO, if any, to be ultimately proposed by CP&L and Duke, the Commission is reluctant to proceed at this time to consider the merits of the Application. Therefore, after careful consideration, the Commission, on its own motion, finds good cause to hold this proceeding in abeyance pending further order.

Company witness Wright also testified that, in the fall of 2001, just weeks before GridSouth was scheduled to begin operations, with so much uncertainty and with the existence of opposing views regarding the formation, structure, and governance of

GridSouth and other RTOs, the project was essentially put in standby mode – meaning that employee hiring ceased and certain systems were canceled or deferred. Given the changes in the FERC's RTO policy, along with the impending issuance of a Standard Market Design Notice of Proposed Rulemaking, witness Wright testified that the GridSouth participants were prudent in reevaluating the wisdom of proceeding with their initial RTO plans.

On February 22, 2002, Duke and CP&L filed a notice of withdrawal of their GridSouth Joint Application to the Commission, which was allowed by Order dated February 25, 2002. In that Order, the Commission also closed all related dockets. These dockets were never reopened.

Company witness Wright testified that the FERC released its Standard Market Design White Paper shortly after it instituted the mediation process intended to result in the formation of four large regional RTOs. In June 2002, the three GridSouth participants terminated the project.

Public Staff witness Maness testified that on June 25, 2002, the GridSouth participants filed a letter with the FERC stating that they were postponing the filing of revised state applications because of two new developments: the preparation of an RTO cost-benefit study for the Southeastern state commissions and the initiation by the FERC of the Standard Market Design rulemaking.

Witness Maness noted that on October 15, 2003, the GridSouth participants filed a letter with the FERC stating that the GridSouth participants had terminated all GridSouth "operational aspects" so as to "cease incurring costs" as of June, 2002. On December 22, 2004, the FERC issued an Order terminating the mediation proceedings aimed at producing a single Southeastern RTO, noting that the mediation attempt had been "unsuccessful." Finally, on October 20, 2005, the FERC issued an Order terminating its GridSouth proceeding at the request of the GridSouth participants.

Witness Maness testified that, in light of all of these events, he did not agree with Duke's inclusion of an amortization of GridSouth costs in the North Carolina retail cost of service. He recommended that the Commission reject the Company's proposed amortization expense of $8,787,000. The effect of witness Maness' adjustment was to reduce the Company's revenue requirement by $9,091,000, as shown on Maness Exhibit I, Schedule 2.

Witness Maness stated that he did not believe that any part of the GridSouth costs that the Company had accrued on its books should be recovered from the North Carolina retail ratepayers, and he offered several reasons in support of his position. Witness Maness stated that it was unclear to him why it was justifiable for the Company to have maintained the North Carolina retail portion of the GridSouth deferred costs as an asset on its books through the end of 2006 without Commission approval and that there was clearly no justification for accruing a return on the costs. He testified that, when the FERC first approved the use of Account 186 for GridSouth start-up costs (in the January 2001 Accounting Order), such approval was granted in an environment where GridSouth was expected to be operational by the end of that year, which would have enabled Duke to recover the costs from GridSouth, not from its retail customers.

Witness Maness testified that, by June 2002, it was clear that the GridSouth initiative was in trouble, and he noted that, by October 15, 2003, the GridSouth participants had terminated all vendor and services contracts, released all GridSouth employees, and sold the building that would have housed GridSouth's headquarters. Thus, witness Maness concluded that, perhaps as early as mid-2002, and certainly by October 2005 (when the FERC terminated the GridSouth proceeding), the Company should have known that the premise for maintaining the costs in Account 186 (that GridSouth was a viable business venture) could no longer be sustained. Witness Maness maintained that, at that point, when there was no longer any argument for keeping the GridSouth costs recorded as an asset except for the hope that they might someday be recovered from some group of customers, the North Carolina retail portion of the costs should either have been written off as a loss or submitted to the Commission for approval of deferral as a regulatory asset. Since the Company had never requested deferral of the costs prior to this rate case, witness Maness opined that it was questionable whether the North Carolina retail portion of the costs should even have been on the books at the end of the test year. On cross-examination, witness Maness also observed that, once it became clear that GridSouth was not going to become operational, the FERC Accounting Order would have lost whatever authority it had for North Carolina retail purposes.

During cross-examination, witness Maness pointed out that Commission Rule R8-27 requires the electric utilities regulated by the Commission to apply to the Commission for approval of any use for North Carolina retail purposes of the specific account numbers set forth in the FERC Uniform System of Accounts for recording regulatory assets and liabilities. Witness Maness testified that, even though Rule R8-27 was amended to include that requirement in September 2001, the amendment occurred before the termination of the GridSouth project, the point in time that the Public Staff believes the costs should have first been considered to be a regulatory asset. Witness Maness observed that the FERC Accounting Order did not address whether the GridSouth costs were a regulatory asset, but instead approved their deferral as something akin to a receivable.

Further, witness Maness testified that, notwithstanding Duke's failure to request approval for regulatory deferral of the North Carolina retail portion of the GridSouth costs prior to this current proceeding, it nevertheless should have begun amortizing the balance it had deferred as soon as it was clear that the amount was in substance a regulatory asset. Witness Maness explained that this has been the practice of the Commission with regard to regulatory assets, such as deferred costs of major storms, and there is no reason to think that this policy should not have been applied in this instance. Because this amortization should have begun arguably as early as mid-2002, and certainly no later than the autumn of 2005, all or at least a significant portion of the costs deferred by the Company should already have been amortized by the time the rates approved in this case go into effect, if one accepts a five-year amortization period. Witness Maness also stated that, upon review of Company witness Wright's testimony that the GridSouth participants had "terminated" the project in June 2002, he felt much more confident in stating that the amortization of the regulatory asset, if one should ever have been approved, should have begun in June 2002, when the costs changed from a "quasi-receivable" to a regulatory asset.

In response to questions from the Commission, witness Maness agreed that the length of the amortization period is decided "on a case-by-case basis." Further, "for the types of expenses that I think are comparable to GridSouth, such as a major storm where you have a unique event that the Commission has some discretion in determining what the appropriate amortization period is and when it should begin, for those types of costs ever since about 1989 with Hurricane Hugo the Commission has consistently had that amortization begin the date that the event took place or in the same month or the same quarter." Witness Maness testified that amortizations have ranged in length "all the way from approximately three years to five and maybe in some cases ten." And, upon further cross-examination, witness Maness agreed that some amortizations related to plant abandonments in the 1980s were done over 10 years.

In addition, witness Maness testified that it was his opinion that the inclusion in rates of any of the costs deferred by Duke would be unreasonable for the simple reason that it would impose higher transmission-related costs on the Company's North Carolina retail customers than likely would have been imposed on those customers if GridSouth had become an operational RTO. As noted previously, if GridSouth had gone forward, the costs deferred on the Company's books would have eventually been paid for by GridSouth and become part of GridSouth's costs. As such, they would have been recovered through the rates that GridSouth would have charged customers for purchasing transmission service. In any GridSouth proceeding before the Commission, witness Maness opined that the Public Staff would likely have recommended that the North Carolina retail ratepayers be held harmless from any adverse effects on either the Company's service or its rates resulting from its membership in GridSouth. Moreover, witness Maness commented that the Public Staff could see no reason why the Commission would not have excluded from the Company's rates all direct and indirect costs associated with the formation and operation of GridSouth in much the same manner as it excluded similar costs when it allowed Virginia Electric and Power Company, d/b/a Dominion North Carolina Power (DNCP), to integrate with PJM Interconnection, LLC (PJM). In requesting amortization of GridSouth deferred costs, however, witness Maness asserted that the Company was proposing to do what it most likely could not have done had GridSouth become operational – namely, require the North Carolina retail customers to pay both the traditional embedded costs of bundled transmission service and some of GridSouth's costs.

Witness Maness elaborated that if the Company had come to the Commission for approval to transfer functional control of its transmission assets to GridSouth, the Public Staff would have taken a "strong position" that in order to hold the ratepayers harmless from that transfer, any additional GridSouth costs over and above the Company's own transmission costs would need to be offset by benefits from GridSouth operation before the costs could be allowed to be included in North Carolina retail rates. Since GridSouth never became operational, witness Maness asserted that there is now no chance for the North Carolina retail ratepayers to experience any of those benefits;

therefore, if the costs were now to be passed on to North Carolina retail customers, they would not in fact be held harmless from the effect of GridSouth.

With regard to the DNCP-PJM Order, witness Maness was cross-examined regarding the fact that, in that proceeding (Docket No. E-22, Sub 418), DNCP explicitly offered to forego recovery of increases in costs due to certain PJM charges. Witness Maness acknowledged that such was the case, but pointed out that the Commission indicated in its Order that DNCP's offer was not sufficient to protect ratepayers, primarily because it was for a limited period of time, and the Commission ordered that the exclusion of those costs would continue indefinitely until further Commission Order.

In response to questions from the Commission, witness Maness acknowledged that the Public Staff had not investigated whether the GridSouth costs that the Company was proposing to amortize were incurred prudently because the GridSouth matter never proceeded to hearing or the filing of comments related to the relevant substantive issues. However, witness Maness stated that the reasonableness and prudence of the costs was irrelevant to the Public Staff's position in this case because, whether the costs were prudent or imprudent, the ratepayers should be held harmless from adverse effects on their rates or service.

Duke witness Wright testified that, from his perspective, the decision by the Company to pursue a North Carolina and South Carolina based RTO was proper, based on the then-current circumstances, in that the successful implementation of this plan would have left the control and oversight of this RTO, to the extent possible, within this region and preserved the jurisdiction of the Commission and the South Carolina Commission over retail transmission service. Witness Wright further testified that the FERC's approach to RTO formation was to "strongly" encourage transmission owners to participate "voluntarily" while remaining "neutral" as to organizational form of an RTO, provided that it satisfied the FERC's "minimum characteristics and functions. . . ." Witness Wright asserted that, at the time of Order No. 2000, the FERC was clearly committed to the formation of RTOs, although the FERC's approach at that time allowed for variations in the structure and functions of RTOs in order to accommodate local concerns and interests. Witness Wright maintained that this strong "encouragement" by the FERC came to be correctly interpreted by the industry as a mandate.

Witness Wright observed that, in order to strongly "encourage" RTOs, the FERC had clearly signaled that utilities not joining an RTO would be subject to substantial risks, including the possible loss of their ability to sell power at market-based rates in wholesale markets. Witness Wright contended that there was simply no question that the Company had to begin planning the development of an RTO or begin discussions related to joining an existing RTO. At the time of the issuance of FERC Order No. 2000 on December 20, 1999, according to witness Wright, each of the GridSouth participants was faced with one of three unenviable choices: (1) developing a North and South Carolina based RTO within 10 months; (2) convincingly demonstrating to the FERC why they could not form an RTO while other utilities were doing just that; or (3) facing the probability of being subject to the jurisdiction and rules of other RTOs that were beginning to be developed in other southeastern states.

During cross-examination, witness Wright agreed that, in the rulemaking proceeding that led up to the adoption of Order No. 2000, Duke had argued to the FERC that until state commission review of restructuring and RTOs was completed, it would be premature for a utility to commit to an RTO membership. While witness Wright agreed that it was a permissible option for a utility to make a filing stating that it had not had time to do a cost benefit study or that the State in which it operated had not pursued restructuring, he asserted that such a filing would not have been practical. Witness Wright remarked that he did not know of any utilities in the Southeast that had done so. On the contrary, witness Wright stated that, since every other Southeastern investor-owned utility had responded to the FERC's Order 2000 by undertaking the development of an RTO, it would have been untenable for the Company and other North Carolina and South Carolina utilities to argue to the FERC that they could not form or join an RTO.

According to witness Wright, based on FERC Order No. 2000, the Company and its GridSouth participants felt that an RTO covering the North Carolina and South Carolina region would best suit customers and regulators in that it would be: focused in its scope; more attuned to the customer and system needs of the Carolinas; and more cost effective than other alternatives. Witness Wright opined that the GridSouth participants also believed that their mutual cooperation and similar state regulatory oversight would provide a smooth transition to an RTO environment since the three companies had a long and positive history of operating their systems cooperatively. Witness Wright observed that GridSouth represented a unique opportunity to create a locally-based RTO answerable to the customers of North Carolina and South Carolina, which the Company believed was preferable to both it and this Commission than the alternatives. At the time the decision to enter the project was made, it was witness Wright's opinion that all indications were that GridSouth complied with the FERC's RTO requirements.

Witness Wright asserted that it was prudent and reasonable for the Company to continue with the GridSouth development in the 2000/mid-2002 time frame. He stated that, in the January 25, 2001 Declaratory Order, the FERC granted the GridSouth participants' request to treat their ongoing investment in GridSouth as a deferred debit and to accumulate carrying costs on the underlying amounts. Witness Wright testified that the FERC Declaratory Order signaled to the GridSouth companies early on that their proposed response to Order No. 2000 was an acceptable one and that, in doing so, signaled the GridSouth companies that they should continue development of the RTO. Witness Wright also observed that the FERC response to the GridSouth application in its March 14, 2001 order generally accepted the application as being compliant with its initial RTO directives. Furthermore, the FERC encouraged the GridSouth participants to meet with Santee Cooper and other Southeastern utilities in an effort to expand the geographic scope of GridSouth. Witness Wright commented that the GridSouth participants complied with this directive and were pursuing these issues when the chairmanship of the FERC changed and the FERC's overall approach to RTOs was altered.

According to witness Wright, this change in the leadership at FERC dramatically altered the FERC's approach to RTO issues. Essentially, as explained by witness

Wright, the FERC abandoned its collaborative effort at creating regional RTOs and became rather dictatorial in its approach to RTO formation. Witness Wright noted that this change, along with other changes, essentially led to both Congressional and state pressure against the FERC's proposed new RTO policies. During this time period, the formation of GridSouth was no longer viewed as consistent with the Company's, the State's, or the Nation's transmission requirements.

Witness Wright maintained that it was prudent for the Company to initially suspend and then terminate the GridSouth project. After the two FERC Orders in July 2001, "[t]here was simply no question that the FERC's RTO policy had dramatically changed, and that this change was not supported by either the GridSouth partners or the utility commissions in either North Carolina or South Carolina." Witness Wright further testified that Duke's participation in GridSouth was a required response to the FERC Orders, and that the GridSouth development costs should be deemed legitimate and proper expenses allowable for recovery. Witness Wright further contended that regulated utilities must respond to, and remain in compliance with, the directives of regulators that have jurisdiction over them, and that costs incurred to do so are a necessary part of utility operations. Also, Witness Wright stated that, if Duke had not developed GridSouth, the FERC would have taken steps to limit the Company's participation in the wholesale power market, and that the Company's North Carolina customers have received over $75 million in benefits under the Bulk Power Marketing (BPM) Sharing Arrangement.

Witness Wright argued that, because these and other costs were incurred to meet directives of a federal regulator, they are a necessary element in the overall costs related to the provision of electric service to the North Carolina retail customers; they were prudently incurred; and they should be recoverable from ratepayers. However, on cross-examination, witness Wright acknowledged that the Commission has the authority to disallow the unrecovered GridSouth development costs at this time.

Witness Wright observed that witness Maness was correct in stating that Duke would have recovered the GridSouth startup costs from GridSouth had GridSouth become operational. However, witness Wright argued that witness Maness failed to state the source from which GridSouth would have received the money to pay Duke. If GridSouth had become operational, according to witness Wright, it would have begun to reimburse the utilities that provided the start-up funding. Witness Wright pointed out that GridSouth would have required a revenue stream to begin paying that obligation. As noted in the October 16, 2000 GridSouth compliance filing, witness Wright explained that GridSouth would be collecting rates for its services, including start-up costs, from all transmission users through the Transmission Service Charge (TSC), including the retail customers of the GridSouth participants. According to witness Wright, the Company would have incurred costs in paying GridSouth its TSC and would have, in turn, included those costs as a cost of service for retail customers. Witness Wright indicated that the intent was to ultimately recover these costs from retail customers.

Witness Wright disagreed with the Public Staff's assertion that the Company should have filed with this Commission several years ago for approval of these development costs as a regulatory asset. Witness Wright testified that the GridSouth partners had already made a filing with the FERC, which has jurisdiction over RTOs, with respect to these development costs. In the Declaratory Order, the FERC agreed to defer the recovery of start-up costs until the RTO was operational, and made it plain that such costs would be recoverable from customers. However, witness Wright acknowledged on cross-examination that the Declaratory Order made it clear that GridSouth would have to submit a separate Section 205 filing to recover the initial costs, and that even the Company and the other petitioners had asserted that the allocation of the costs between retail and wholesale jurisdictions was beyond the scope of their petition in that proceeding. Witness Wright opined that the FERC was the proper forum in which to address the accounting treatment for these costs, because it was "controlling the cost and controlling the process."

In addition, witness Wright disagreed with the Public Staff's assertion that the Company should have begun amortizing these costs no later than 2005. Witness Wright argued that amortization should begin at the point the Company begins to recover these costs from customers and that this proceeding is the first opportunity the Company has had in which to seek such recovery from North Carolina retail customers.

Further, witness Wright disagreed with the Public Staff's position that retail customers should be held harmless from any adverse affects of GridSouth and that allowing recovery of these development costs would violate this principle. He stated that witness Maness's argument assumes that, had GridSouth become operational, there would be no benefits or savings resulting from the GridSouth operations, a belief that the FERC would take issue with. However, he conceded on cross-examination, that the cost benefit study prepared for the Southeastern Association of Regulatory Utility Commissioners (SEARUC) demonstrated that GridSouth was not cost-effective under any of the scenarios studied. Witness Wright also explained that witness Maness also assumes that, had the FERC allowed recovery of these development costs from all transmission users, somehow this Commission could have ignored these FERC-mandated costs. Witness Wright asserted that such a position is contrary to established precedent and constitutes bad public policy. In response to questions from the Commission, witness Wright stated that he was making essentially a policy and equity argument, rather than a legal one.

Witness Wright testified that other states had allowed recovery of RTO development costs. Witness Wright testified that South Carolina allowed recovery of GridSouth costs for SCE&G, in Docket No. 2004-178-E, Order No. 2005-2, January 6, 2005, and that other states have allowed recovery of RTO startup costs as well, including Florida (Progress Energy Florida) and Mississippi (Entergy).

In its Brief, Duke argued that the Commission's Order in the DNCP-PJM Docket is not indicative of what the Commission might have done relative to GridSouth. In particular, Duke stated that

> [U]nlike PJM, the GridSouth participants specifically designed GridSouth to be a locally based RTO answerable to the customers of North Carolina and South Carolina. The Company believed such a RTO structure was preferable to this Commission than the alternatives. (T. Vol. 4, p.139)

Second, Dominion had already agreed as a part of a settlement in its rate case to charge all PJM start-up costs to non-utility operations. In the Matter of Dominion North Carolina Power – Investigation of Existing Rates and Charges, Docket No. E-22, Sub 412 (March 8, 2005) at p 8. Third, Dominion North Carolina Power specifically offered to exclude various PJM costs from its North Carolina retail rates (Dominion PJM Order at p. 12) and could do so without significant financial impact due to the small percentage of its North Carolina retail jurisdiction to its total system (T. Vol. 4, pp. 114-15). Accordingly, this Commission expressly stated that:

> Finally, the Commission finds that the facts and circumstances in this matter are unique, that this case is a very close one, that any application of this nature must be independently reviewed and evaluated with respect to the specific evidence presented in that case, and that this decision shall not serve as a precedent with respect to any future request by a utility to join an RTO or otherwise transfer operational control over its transmission facilities.
>
> Dominion PJM Order at p. 27.

Duke argued that there is no basis in law or policy for the Public Staff's position that the Commission should disallow recovery for costs prudently incurred in response to a federal regulatory mandate simply because the Public Staff disputes the merits of the federal policy.

Duke argued that "this rate case is the first opportunity the Company has had to" seek approval for the recovery of the costs in rates. "When it became clear in the middle of 2002 that GridSouth would not come into being, the Clean Smokestacks Act. . . imposed a rate freeze through December 31, 2007." Duke argued that none of the permitted exceptions to the freeze would have covered the GridSouth development costs because, although they resulted from government action, neither the costs nor the government action occurred during the rate freeze period as the statute required. Duke argued that "it was necessary for the Company to wait until the freeze was over to seek recovery in retail rates."

In its Proposed Order, the Public Staff asserted that Duke should not have incurred significant start-up costs before the FERC issued an Order with respect to whether or not GridSouth, as proposed, was acceptable. The Public Staff argued that the FERC's provisional approval of GridSouth in its March 14, 2001 Order was on terms that were unacceptable to the GridSouth participants and to the Commission. When FERC refused to clarify the March 14 Order and instead imposed additional objectionable requirements, it should have been clear to the GridSouth participants that no further expenditure of funds was appropriate. The Public Staff pointed out that the Commission's concerns with those requirements were expressed in its August 2001 Request for Rehearing and Motion for Stay in the FERC GridSouth proceeding and its subsequent motion to join the appeal of the FERC's GridSouth Orders to the United States Court of Appeals for the Fourth Circuit.

In its Proposed Order, the Public Staff commented that, with respect to Duke's late-filed exhibit response 9-1, it is inappropriate for only 4.5%, or $2.8 million out of the $62.4 million total, to be borne by the wholesale jurisdiction - the jurisdiction that gave rise to the costs in the first place. The Public Staff observed that, during the period of the BPM Sharing Arrangement, Duke's shareholders received over $75 million in benefits. Similarly, the Attorney General argued in its Brief that, "if FERC allows Duke to recover its GridSouth costs in its wholesale transmission rates, then those costs will reduce the net transmission revenues received by North Carolina's retail ratepayers. . . . Any additional GridSouth costs recovered from North Carolina retail ratepayers should be recovered from the Industrial Class."

In its Brief, the Attorney General contended that "Duke's reliance on a FERC Order allowing deferral of GridSouth start-up costs until the RTO became operational is misplaced." In addition, the Attorney General observed that "Duke failed to request that the Commission defer Duke's GridSouth costs for later recovery, even though Duke had the opportunity to do so in the GridSouth docket that was opened by the Commission at Duke's request in April 2001."

Further, the Attorney General argued that, even if Duke had requested deferral of the GridSouth costs and the Commission had found deferral to be in the public interest, the Commission likely would have ordered, at most, a five-year deferral schedule, beginning no later than the month in which Duke knew that GridSouth was no longer feasible and thus ceased incurring costs, which was in June 2002. The Attorney General noted in his Brief that "as a general rule the Commission has not favored cost deferrals, allowing deferral only when expenses are unusual and would have a material effect on a company's financial position."

In addition, the Attorney General maintained that under the Clean Smokestacks Act, cost deferrals were prohibited during the rate freeze period - June 20, 2002 through December 31, 2007 - unless the Commission found such deferrals to be in the public interest. (G.S. 62-133.6(e). The Attorney General remarked that the purpose of this section was to prevent a utility from eroding the benefits of the rate freeze by deferring costs and including them in rates set after the rate freeze. The Attorney General asserted that Duke's request to defer GridSouth costs and include them in rates beginning in 2008 would defeat that purpose. The Attorney General concluded that, "Duke having failed to give the Commission the opportunity to determine whether the public interest would have been served by deferring the GridSouth costs during 2002 through 2007, its present request to include those costs in retail rates should be denied."

Both the Public Staff and the Attorney General argued that the Company should have been aware that the deferral of GridSouth development costs for North Carolina retail regulatory purposes would require an application to the Commission pursuant to the Clean Smokestacks Act.

The Commission believes that a proper resolution of the GridSouth issue requires a two-step analysis. First, the Commission must determine whether any deferral of GridSouth-related costs for subsequent amortization is lawful under the

Clean Smokestacks Act. Second, the Commission must determine whether allowing deferral and subsequent amortization in rates of GridSouth-related costs is consistent with considerations of sound regulatory policy and, if so, how any allowed deferral and amortization of GridSouth-related costs should be structured. The Commission will address each of these issues in turn.

The North Carolina General Assembly enacted the Clean Smokestacks Act in 2002. By its explicit terms, the statute precludes changes in base rates and certain cost or revenue deferrals during a rate freeze period which began on June 20, 2002, and runs through December 31, 2007. A number of exceptions to the statutorily-mandated rate freeze are specified in the Clean Smokestacks Act, including one relating to a "[g]overnmental action resulting in significant cost reductions or requiring major expenditures, including, but not limited to, the cost of compliance with any law, regulation, or rule for the protection of the environment or public health, other than environmental compliance costs." G.S. 62-133.6(e)(1)a. Duke interprets this section of the Act to have precluded it from seeking a deferral order from this Commission relating to GridSouth-related expenditures at any time prior to this proceeding because the governmental action which caused the expenditures occurred <u>prior to</u> the effective date of the Clean Smokestacks Act. Thus, according to Duke, these costs could not have been deferred prior to this proceeding because the governmental action which resulted in the expenditures did not occur during the rate freeze period. On the other hand, the Attorney General argued that the deferral Duke seeks in this case is prohibited by the Clean Smokestacks Act unless the Commission finds that such deferral was permitted by one or more of the exceptions set forth G.S. 62-133.6(e)(1).

The Commission concludes that Duke and the Attorney General have both misinterpreted the literal language of the statute and the intent of the General Assembly. According to G.S. 62-133.6(e), "the base rates of the investor-owned utilities shall remain unchanged from the date on which this section becomes effective through December 31, 2007." G.S. 62-133.6(e)(1) further provides that "the Commission may, consistent with the public interest," "[a]llow adjustments to base rates, or deferral of costs or revenues, due to one or more of the following conditions occurring during the rate freeze period . . . " Thus, the literal language of G.S. 62-133.6(e)(1) provides that (1) there shall be no change in base rates during the rate freeze period and that (2) adjustments to base rates or deferrals of costs or revenues during the rate freeze period may occur in the event that one of the four specified exceptions to the rate freeze exists.

In this case, the Commission is faced with a request that costs incurred <u>prior to the rate freeze period</u> as the result of a governmental action that occurred <u>before the rate freeze period</u> be deferred and amortized to rates <u>after the end of the rate freeze period</u>. This request does not implicate either of the prohibitions set out in G.S. 62-133.6(e)(1). First, nothing about the relief requested by Duke in any way involves a rate change occurring during the rate freeze period. Secondly, nothing about Duke's request would allow a deferral of costs incurred during the rate freeze period.[20]

[20] A portion of the AFUDC accumulated on the balance of the GridSouth costs was capitalized during the rate freeze period. Allowing the deferral and recovery of these costs might be deemed tantamount to allowing the deferral of costs incurred during the rate freeze period despite the fact that the underlying

Since nothing in the statutory language bars the Commission from allowing a rate change after the rate freeze period resulting from costs incurred before the rate freeze period, the Commission is not barred from considering Duke's request on statutory grounds.

The Commission's analysis is fully consistent with the purpose of the Clean Smokestacks Act, which was intended to require the affected utilities to address all costs incurred during the rate freeze period using revenues derived from existing rates and to require that rates remain unchanged during the initial portion of the compliance period. As a result of the general prohibition against establishing prospective rates so as to allow the recovery of prior period costs, Utilities Commission v. Edmisten, 291 N.C. 451, 232 S.E.2d 184 (1977), most rate changes based on pre-rate freeze costs are now barred by ordinary ratemaking principles. However, given that the GridSouth costs at issue here are multi-period costs of a type that are typically recovered over time, allowing the deferral and amortization of such pre-rate freeze costs does not run afoul of this prohibition. Thus, the Commission's decision with respect to the issue of the lawfulness of Duke's request to defer and amortize GridSouth-related costs is fully consistent with the rate freeze provisions of the Clean Smokestacks Act and ordinary ratemaking principles.

Although one could argue that entertaining Duke's request to defer and amortize GridSouth-related costs would be unlawful because the effect of the rate freeze provisions of the Clean Smokestacks Act is to require utilities to use existing, frozen rates to accommodate all costs (including those incurred both prior to and during the rate freeze period) except for those that are encompassed within the four exceptions set out in G.S. 62-133.6(e)(1), that interpretation is inconsistent with the relevant statutory language. On the contrary, the literal language of the statue simply bars rate changes or the deferral of costs or revenues based on events occurring during the rate freeze period unless one of the four exceptions set out in G.S. 62-133.6(e)(1) exists. The statute simply does not address either post-rate freeze rate changes or deferrals of pre-rate freeze costs. Any attempt to construe G.S. 62-133.6(e)(1) to bar otherwise permissible post-rate freeze rate changes or deferrals based on pre-rate freeze costs would import a gloss into the rate freeze statute that lacks support in its literal language.

One could also argue that the decision of the North Carolina Court of Appeals in Utilities Commission v. Carolina Utility Customers Association, Inc., 163 N.C. App. 46, 592 S.E. 2d 221 (2004), dis. rev. den., 358 N.C. 739, 602 S.E. 2d 683 (2004) (CUCA) precludes Duke from requesting and the Commission from granting the deferral of and subsequent amortization of the GridSouth expenditures to rates as a matter of law. The

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governmental action did not occur during the rate freeze period. The Commission's decision does not run afoul of any such interpretation of G.S. 62-133.6(e)(1)a, however, since the Commission has refused to allow the deferral of post-June, 2002, AFUDC on the balance of GridSouth costs as of that date. Similarly, by requiring the amortization period to begin as of June, 2002 without allowing any adjustment to rates, the Commission's decision does not contravene the language or the intent of G.S. 62-133.6(e)(1), since North Carolina retail rates have not and will not under the Commission's order pay rates that include the costs amortized during the initial five years of the Commission-approved amortization process.

Commission disagrees. In CUCA, the Court of Appeals addressed the effect of the rate freeze provisions of the Clean Smokestacks Act on CUCA's request for a rate investigation based on alleged overearning occurring prior to the effective date of the Clean Smokestacks Act. In its complaint, CUCA urged the Commission to review and, if necessary, adjust Duke's rates because Duke was earning a return substantially in excess of the return that the Commission found reasonable in Duke's last general rate case. After reviewing the relevant provisions of the Clean Smokestacks Act, the Court of Appeals held that the Commission was precluded from ordering a change in Duke's rates because CUCA failed to allege that Duke's excessive earnings occurred during the rate freeze period as required by G.S. 62-133.6(e)(1)d. Any rate reduction resulting from alleged over-earning would, by virtue of the date on which CUCA made its filing, have necessarily had to be implemented during the rate freeze period. As a result, the Court of Appeals held that the requested relief could only be granted in the event that one of the four exceptions to the rate freeze existed. Since CUCA did not allege or prove that the factual prerequisites necessary to trigger the applicability of one of the four exceptions to the rate freeze existed, the Court of Appeals affirmed the Commission's dismissal of CUCA's petition.

The Commission has carefully reviewed the facts in the present case and believes that they are readily distinguishable from those at issue in CUCA. In this case, the Commission is faced with a request that costs incurred before the beginning of the rate freeze period as a result of a governmental action that antedated the effective date of the Clean Smokestacks Act be deferred and included in rates after the end of the rate freeze period. By contrast, CUCA sought a change in rates during the rate freeze period based upon alleged over-earnings that occurred prior to the effective date of the Clean Smokestacks Act. The relief requested by Duke in this case does not in any way involve a request for a rate change occurring during the rate freeze period, making it very different from the circumstances at issue in CUCA.

For all of these reasons, the Commission concludes that the Clean Smokestacks Act does not control the circumstances under which Duke may request and the Commission may grant a request to defer and amortize GridSouth-related costs. As a result, Duke's request to defer and amortize GridSouth-related costs should be evaluated under the usual principles applicable to deferral requests rather than being either barred by G.S. 62-133.6(e) or required to fit within the confines of one of the four exceptions to the rate freeze enacted as part of the Clean Smokestacks Act. However, as noted in Footnote 20, any Commission decision addressing the details of Duke's proposal must comport with the Clean Smokestacks Act.

The Commission has long allowed expenses incurred in certain situations to be deferred and amortized over an extended period to reflect the fact that these costs benefit all present and future customers. Utilities Commission v. Edmisten, 291 N.C. 451, 232 S.E. 2d 184 (1977). Classic examples of this principle are reflected in the well-established practice of deferring and amortizing storm restoration and abandoned plant costs over multi-year periods. See e.g., Utilities Commission v. Thornburg, 325 N.C. 463, 383 S.E. 2d 451 (1989). The Commission has generally decided requests for the deferral and amortization of specific cost items by examining whether the costs in question are unusual and material and whether allowing the deferral and amortization request is equitable, taking into account the equities for both shareholders and customers. When analyzed according to the Commission's usual tests, allowing deferral and amortization of the GridSouth-related costs at issue here is consistent with prior Commission decisions, assuming that appropriate modifications are made to Duke's proposal.

The costs in question are clearly quite unusual in that their incurrence resulted from Duke's attempts to comply with FERC orders. FERC orders of the magnitude of Order No. 2000 clearly are not routine events. It is difficult to think of another FERC order that resulted in the perceived necessity for the formation of an entirely new FERC-jurisdictional entity by a date certain. Although Order No. 2000 did not mandate RTO formation in so many words, FERC clearly intended to achieve nationwide RTO formation to the extent possible on a "voluntary" basis. Duke had no choice except to attempt to comply with Order No. 2000. Nothing in the present record suggests that Duke's efforts to comply with Order No. 2000 through the formation of GridSouth or its subsequent decision to suspend and then terminate the GridSouth effort were in any way unreasonable or imprudent. Instead, the evidentiary record clearly establishes that Duke's decision to proceed with the formation of GridSouth and the Company's subsequent decision to suspend and then terminate GridSouth-related activities were both reasonable and prudent given the circumstances existing at the time that those decisions were made. As a result, the costs in question are clearly unusual and not part of the ordinary cost of providing service. In addition, these costs are multi-period in nature; had GridSouth become a functional RTO, the majority of these costs would have been capitalized and recovered over time.

Furthermore, the amounts at issue here are clearly material. The requested deferral involves costs that are comparable to the amount of other deferrals that the Commission has approved in the past. For example, the Commission allowed the deferral of $15.4 million in Docket No. E-2, Sub 894; $23.5 million in Docket No. E-2, Sub 843; $39.8 million in Docket No. E-2, Sub 699; and a combined total of $23.5 million in Docket No. E-7, Sub 460. Although the Commission's analysis in each case was fact-specific, these decisions do suggest that the Commission has been willing to deem amounts similar to that at issue here to be material. Furthermore, while Duke earned a healthy return on its North Carolina retail rate base during the interval following the suspension of the GridSouth project according to contemporaneous "Quarterly Review" reports published by the Commission, that fact alone does not preclude allowance of the deferral request given the unusual nature of the costs at issue here. The level of a utility's earnings is certainly relevant to the Commission's evaluation of a request that costs be deferred and amortized to rates, since a high level of earnings may signal that the utility is able to accommodate the costs sought to be deferred and amortized under existing rates. On the other hand, given the magnitude of the costs in question and the reasonableness and prudence of the decisions that led to their incurrence, the Commission concludes that the level of Duke's earnings should not constitute an absolute bar to the recovery of all GridSouth-related costs in this instance. The Commission has, however, taken the level of Duke's earnings into account in deciding to lengthen the amortization period to ten years (consistent with the Commission's abandoned plant decisions); to treat the amortization period as having begun in June, 2002; and to preclude the inclusion of post-June, 2002 AFUDC in the deferral and amortization process[21], since the effect of this decision is to require Duke to address a significant percentage of these GridSouth-related costs under the rates in effect prior to the effective date of this Order. In addition, the effect of this Order is to reduce Duke's base rates, a fact that also militates against a total disallowance of Duke's request to defer and amortize GridSouth-related costs in light of the Commission's decision to use a 10-year rather than a five-year amortization period. Thus, a decision to allow deferral and amortization of the GridSouth costs in question here under the terms and conditions stated in this Order is not inconsistent with the Commission's prior deferral decisions and is equitable for both shareholders and customers.

The Public Staff vigorously contends that the Commission should disallow Duke's request to defer and amortize GridSouth-related costs because it believes that the Commission would have required Duke to hold North Carolina retail customers harmless from the cost effects of GridSouth had the proposed RTO become fully operational. In addition, the Public Staff contends that approval of Duke's request inappropriately requires Duke's North Carolina retail customers to pay rates that include both the embedded costs of Duke's transmission assets and costs associated with the formation of GridSouth, producing a result that the Public Staff does not believe that the Commission would have countenanced had GridSouth ever become operational. In support of this argument, the Public Staff points to the Commission's decisions with respect to similar issues in Docket No. E-22, Sub 418, in which the Commission allowed DNCP to transfer operational control of its transmission assets to PJM. Although there are certainly similarities between this case and Docket No. E-22, Sub 418, there are also important differences resulting from the fact that the GridSouth participants suspended and then terminated efforts to form GridSouth before it became operational. Acceptance of the Public Staff's arguments involves a degree of speculation about what the Commission would have done in a subsequent transfer proceeding with which the Commission is uncomfortable. In the absence of definitive knowledge about the final structure of GridSouth, a cost-benefit study that was subjected to testing in an adversary proceeding, and similar evidence, it is simply not possible for the Commission at this point to know what it would have done in a GridSouth-related proceeding conducted pursuant to G.S. 62-111(a). Although the Public Staff points to the SEARUC cost-benefit study as evidence that GridSouth was never cost-effective, the results of that study did not become available until after the GridSouth participants suspended their formation efforts in June, 2002. Furthermore, while the Public Staff is correct in pointing out that the Commission would have likely adopted conditions intended to protect North Carolina retail ratepayers as part of any order allowing Duke to transfer operational control of its transmission assets to GridSouth, we cannot determine what those conditions would have been at this late date. Thus, the Commission is not persuaded by the Public Staff's arguments in reliance on the Commission's decision in Docket No. E-22, Sub 418.

The nature and scope of the exact terms and conditions of the deferral and amortization of any item of cost are committed to the Commission's sound discretion.

[21] The inclusion of post-June, 2002, AFUDC might also be prohibited by the rate freeze provisions of the Clean Smokestacks Act, as discussed in Footnote 20.

Among other things, the Public Staff argued that the Commission should refuse to allow the inclusion of any GridSouth-related costs in rates in the exercise of its discretion because Duke failed to seek approval to defer these costs at an earlier time, because Duke did not begin amortizing GridSouth-related costs at the time that the GridSouth participants suspended work on the formation of GridSouth, because Duke incurred costs relating to GridSouth prior to obtaining Commission authorization to defer GridSouth-related costs, and because approval of Duke's request to defer and amortize GridSouth-related costs would require retail customers to pay an inappropriately large portion of the costs in question despite the fact that they were primarily incurred for the purpose of improving the operation of wholesale bulk power markets. In the Commission's view, some of these arguments are unpersuasive and others are more appropriately directed to the terms and conditions under which deferral and amortization of GridSouth-related costs should be allowed rather than to whether deferral and amortization should be permitted at all.

Although the evidentiary record establishes that Duke and the other GridSouth participants began to incur GridSouth-related costs before GridSouth had been approved by either the FERC or the Commission, that fact should not, in the Commission's opinion, bar deferral and amortization of some level of GridSouth-related costs in this proceeding. According to Order No. 2000, FERC-jurisdictional public utilities were required to make their compliance filings by October 1, 2000, and to have any new RTO proposed in those compliances filings up and running by December 1, 2001. The undisputed evidence reflects that the GridSouth participants began to incur costs associated with the formation of the proposed RTO prior to FERC and Commission approval in an effort to meet the deadlines set out in Order No. 2000 and that compliance would not have been possible except for the incurrence of these costs. In addition, it is not generally necessary for utilities to obtain regulatory approval before incurring similar items of cost. Although G.S. 62-101(a) requires the issuance of a certificate before a utility can begin to construct new transmission lines over a certain voltage and G.S. 62-110.1(a) requires utilities to obtain a certificate before incurring costs associated with new generating facilities, the same is not true of RTO-related costs. Instead, such costs are generally addressed through the ordinary ratemaking process. As a result, the fact that Duke failed to seek and obtain FERC and Commission approval before beginning to incur GridSouth-related costs is not a bar to consideration of Duke's request in this proceeding.

The record does clearly reflect that Duke failed to seek Commission approval to defer and amortize these GridSouth-related costs prior to initiating this proceeding and that Duke has yet to begin amortizing them. Despite the fact that these costs did not fit within the scope of the "governmental action" exception to the Clean Smokestacks Act rate freeze, nothing prohibited Duke from at least bringing this issue to the Commission's attention at an earlier time. Although the Company argues that the FERC allowed the deferral of these costs, FERC accounting orders are not binding on this Commission for retail ratemaking purposes. Furthermore, the Commission agrees with the Public Staff that, as a matter of ordinary practice, amortization of deferred costs should begin as soon as the relevant regulatory asset is or should be established. As a result, the Commission concludes that it would have been preferable for Duke to have signaled to the Commission at an earlier time that it intended to seek a deferral and amortization of these GridSouth-related costs and that the Company should have begun to amortize these GridSouth-related costs at the time that it suspended its RTO formation efforts in June, 2002. Thus, the Commission has structured the deferral and amortization approach it has approved in this proceeding so as to lengthen the amortization period; to require that amortization be deemed to have begun in June, 2002; and to decline to allow the deferral and amortization of post-June, 2002, AFUDC in rates. By adopting this approach, the Commission believes that it has acted consistently with its prior decisions concerning plant abandonment issues and has required an appropriate sharing of these GridSouth-related costs among retail ratepayers, wholesale customers, and shareholders.

The fact that the primary purpose of the FERC's efforts to facilitate RTO formation was to improve the operation of the wholesale market does not bar approval of a request to defer and amortize the costs at issue here either. Although the large majority of the energy sold by Duke at retail is generated in utility-owned facilities, the Company does purchase power on the open market for resale to its retail customers. Furthermore, the level of a utility's involvement in the wholesale market affects the amount of generation, transmission, and other costs assigned to retail customers through the ordinary jurisdictional allocation process. For that reason, singling out the industrial class to bear all allowable GridSouth-related costs, as recommended by the Attorney General, is not appropriate. On the other hand, the fact that Duke's wholesale customers would, in all likelihood, obtain greater benefits from improved wholesale markets than Duke's retail customers does suggest that the amount of GridSouth-related costs included in retail rates should be limited. The approach to the deferral and amortization of these GridSouth-related costs approved by the Commission accomplishes this result by substantially reducing the annual amount included in Duke's cost of service for retail ratemaking purposes.

As a result, the Commission concludes, for the reasons stated above, that the deferral and amortization period should be deemed to have begun in June 2002; that the proposed amortization period should be extended to 10 years; and that no carrying charges accruing after June, 2002 should be included in the deferral and amortization process. More specifically, the Commission finds and concludes that it is appropriate to include $2,906,000 as an operating expense in Duke's cost of service to amortize the North Carolina retail portion of GridSouth investment incurred prior to the end of June 2002, over a 10-year period beginning June, 2002. In recognition of the unique facts and circumstances at issue here, the Commission has essentially approved the creation of a regulatory asset *nunc pro tunc* to June, 2002, and limited the approved amortization to costs that were incurred prior to the end of June, 2002. This treatment of GridSouth costs for deferral and amortization is lawful, generally consistent with the traditional treatment of abandoned plant costs by the Commission, and fair to both shareholders and ratepayers.

The Commission has carefully considered the positions of the Public Staff, the Attorney General, and Duke in reaching this decision. The situation surrounding the GridSouth participants' efforts to form an RTO is unique. In fact, the Commission believes that this issue is essentially "one of a kind." The Commission concludes that Duke acted prudently in pursuing GridSouth, and that it acted prudently in suspending and later abandoning GridSouth as well. Duke's involvement in the attempted formation of GridSouth clearly represented an effort to comply with Order No. 2000 in a manner that was responsive to the interests of North Carolina retail customers. The Commission also agrees with the Public Staff and the Attorney General that, with the benefit of hindsight, Duke should have sought the Commission's approval to create a regulatory asset relative to the GridSouth development costs and to have begun amortizing these costs at an earlier time. However, Duke incurred GridSouth costs in a time of rapidly changing regulatory requirements. It would have been difficult for Duke to know, at that time, that the GridSouth effort would not continue to evolve so that it became acceptable to both FERC and the Commission or that, on the contrary, the time had come to request deferral and amortization. In essence, the Commission has treated the GridSouth cost issue in this proceeding as tantamount to an abandonment loss. In such instances, the Commission has allowed the recovery of prudently incurred costs over an appropriate period of time without allowing a recovery on the unamortized balance (Duke has not requested to be allowed to include a return on the unamortized balance of GridSouth-related costs in this proceeding). The application of these principles in the plant abandonment context has been upheld on appeal, Utilities Commission v. Thornburg, 325 N.C. 463, 385 S.E. 2d 451 (1989), and the Commission sees no reason why they are not applicable to the GridSouth-related costs at issue here. Thus, the Commission concludes that the ratemaking treatment of GridSouth costs set forth in this Order is reasonable and appropriate for purposes of this proceeding.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 35

The evidence relating to this finding and conclusion is found in the testimony of CIGFUR III witness Phillips and Duke witness Bailey.

The Company's Rider IS is a special rate for interruptible service to nonresidential customers. CIGFUR III, through witness Phillips, proposed a number of changes to Rider IS and requested that the Commission consider those changes in this docket. First, witness Phillips proposed that the method of calculating the credit for Rider IS customers, which currently is $3.50 per kW, be changed to provide a substantially larger credit, based on either a sharing of 50% of the "avoided cost" of the interruptible load, which would imply a credit of $8.00 per kW, or an "equivalent peaker" approach, which would yield a credit of $6.75 per kW. Second, witness Phillips proposed that the Company be required to lift the suspension of Rider IS and to open it to new load, using either the 1,100 MW cap established in 1991 or a cap of at least one-half that amount (550 MW) as the limit on allowable participation in Rider IS. Finally, witness Phillips disputed the Company's position that Rider IS should be permitted to remain as it is until the Company's application in Docket No. E-7, Sub 831 for approval of its "Save-a-Watt" Energy Efficiency Program can be considered.

Company witness Bailey testified in rebuttal to witness Phillips' testimony. Witness Bailey presented the Company's position that issues related to Rider IS and all other existing DSM programs should be considered in Duke's pending Docket No. E-7, Sub 831, rather than in this rate case. Witness Bailey stated that the Commission had expressed its intent, in bifurcating the Energy Efficiency Docket from this docket, to take up the Energy

Efficiency Docket next year after the rulemaking implementing Senate Bill 3 is completed, and there will be no significant harm or delay in waiting until then to consider such issues.

With respect to witness Phillips' recommendations for changes to Rider IS, witness Bailey first pointed out that witness Phillips' proposal to base the credit for Rider IS customers to one-half of the demand charge for firm service is without merit because it does not take account of the fact that the demand charge is based on embedded costs for existing resources, which are unavoidable costs. Turning to witness Phillips' "equivalent peaker" method for sizing the credit, witness Bailey stated that such an approach fails to consider the market demand for interruptible products, program attributes that affect the value of the program to the utility (such as length and frequency of interruptions), and customers' perceptions of the value of the program. Witness Bailey responded to witness Phillips' recommendation that Rider IS be reopened by stating that the Company believes its decision to continue all existing DSM programs in their present state until the Energy Efficiency Docket is decided is correct.

The Commission agrees with Duke that changes to Rider IS should be considered in Docket No. E-7, Sub 831, together with the other proposals in Duke's Save-a-Watt filing. Having bifurcated the Save-a-Watt docket from this general rate case proceeding, consideration of issues relating to Rider IS in Docket No. E-7, Sub 831, where the Commission can consider the full complement of EE and DSM measures, is appropriate. Additionally, considering Rider IS in isolation has limited benefit, since whatever decision the Commission might make in this docket on Rider IS would probably have to be revisited during the Commission's consideration of Duke's application in Docket No. E-7, Sub 831. The Commission, therefore, concludes that it should defer consideration of changes to Rider IS to Docket No. E-7, Sub 831 and transfer to that docket, in addition to the consideration of the new programs proposed by Duke, the issue of what changes, if any, are appropriate to existing DSM and EE programs such as Rider IS.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 36

The evidence supporting this finding of fact and conclusion is found in Duke's verified Application and Duke's Form E-1 Rate Case Information Report, the Stipulation, the testimony and exhibits of Duke witnesses Bailey and Yarbrough, the Attorney General's October 15, 2007 Statement of Position, and the entire record in this proceeding.

Duke argued that there is no reason to change the definition of "customer" in Leaf A or the Denial and Discontinuance provisions of Leaf G in the Company's tariffs. The Attorney General has argued that the definition of "customer" should be changed so that it excludes users that are not explicitly named on the account and that the provisions regarding denial and discontinuance of service should be changed to eliminate provisions that the Commission has previously approved. On the other hand, Duke argued that there is no evidence in the record to support the changes proposed by the Attorney General and that the irrefutable evidence establishes that the current language is working well and strikes the appropriate balance between maintaining the Company's ability to maximize collections from unscrupulous users of electric service while avoiding undue harm to other customers.

Duke asserted that the Company's definition of the term "customer" has not caused confusion or complaint from customers. Instead, the Company maintained that it is a tool that Duke and other utilities in the Southeast use to subject the user of the service to the Rate Schedules, Service Regulations, and the Commission's Regulations for the purpose of mitigating nonpayment problems and reducing energy theft. Company witness Yarbrough explained that the definition of "customer" in the Service Regulations is applied so as to make the user of the service responsible for paying for it in cases where the user and the customer of record are not the same person, such as when the customer of record is deceased or when there is no customer of record (such as in cases of energy theft). Witness Yarbrough testified that a more restrictive definition could make it difficult to police fraudulent and abusive evasion of bills for service.

Duke contended that the provisions in Leaf G, like the Commission's policy on deposits set forth in Rule R12-1, are designed "to avoid, to the extent practicable, the creation of a burden arising from uncollectible bills which would have to be borne ultimately by all the utility's ratepayers." Duke explained that the provisions of Leaf G are designed, like deposits, to deal with attempts to avoid payment of bills rendered by a utility with an obligation to provide service, and that those provisions, in turn, save paying customers money. According to Duke, the Attorney General presented Yarbrough Cross-Examination Exhibit No. 5, which purported to show 127 undesignated, "disputed bill" informal complaints raised with the Public Staff in the nine-month period from January through September 2007, in an effort to establish the existence of a problem. However, Company witness Yarbrough noted that there were only 127 such informal complaints out of approximately 11.7 million bills, and not a single one of those 127 complaints resulted in a formal customer complaint filed with the Commission challenging the existing policy. Duke emphasized that those complaints that have been brought to the Commission in recent years have been resolved in favor of Duke, either by withdrawal or dismissal following hearing. Duke further noted that neither the Public Staff nor any other party to this proceeding advocates the Attorney General's proposed changes. The Service Regulations at issue have been in place in essentially the same form since 1944, and according to Duke, the Company's policy has worked well and continues to serve its customers well. Duke also pointed out that the Commission continues to enforce regulations of a similar nature in cases involving other utilities subject the Commission's jurisdiction. Delaney v. Progress Energy Carolinas, Docket No. E-2, Sub 905 (Sept. 20, 2007) (Commission finding resident jointly responsible with account holder for past due electric bills). As a matter of logic and policy, Duke concluded that there is no compelling reason to change either the definition of "customer" or the provisions for denial and discontinuance of service, so the Company asked that the Commission approve the Service Regulations as set forth in Exhibit A to the Stipulation.

Duke believes that changing the definition of "customer" and/or the provisions for denial and discontinuance of service invites attempts to avoid payment and could unjustly enrich those who refuse to pay the bills that they owe. Duke argued that the changes proposed by the Attorney General to these sections of the Company's Service Regulations could add the unnecessary and expensive step of requiring Duke to seek restitution from an electricity user who has not paid amounts owed. Seeking restitution can be a time consuming and expensive process for both the Company and the user and is unnecessary under the current system. For the 2006 test year, Duke reported $18.8 million in uncollectible expenses (system-wide), which was reduced to a net expense of approximately $10.5 million due to Duke's collection efforts under the existing regulations. (Duke's Late-Filed Exhibit No. 1, filed October 26, 2007.) Duke maintained that the current system, using the existing definition of "customer", saves all involved from the potential for costly litigation while providing the Company and its other paying customers with the collections to which they are entitled.

The Attorney General responded that Duke's service regulations establish important terms under which consumers must contract with Duke, a monopoly provider, in order to receive and pay for essential electric service. Therefore, the service regulations should comport with North Carolina laws governing contracts and debt collection practices. The Attorney General argued that, as applied by Duke, the service regulations are contrary to North Carolina law in three respects. First, Duke applies the regulations to hold Customer A responsible for former Customer B's electric bill even though Customer A has no legal obligation to pay Customer B's bill. Second, Duke enforces the above practice by transferring Customer B's unpaid bill to Customer A's account and threatening to terminate customer A's electric service if Customer B's bill is not paid. Third, Duke improperly represents the extent of Customer A's obligation to Duke and improperly discloses information about Customer B's debt to Customer A.

Specifically, the Attorney General proposed the five following findings:

1. For the purpose of defining and enforcing the payment obligations of persons who receive electric service, the provisions of Section XII.8 and XII.6 in Duke's Service Regulations are overly broad and inconsistent with North Carolina contract law.

2. There is no legal authority or rational basis for Duke to require or receive information from applicants about the names, relationship to the applicant, and Social Security numbers of other adults living in the applicant's household.

3. There is no legal authority for Duke to collect or attempt to collect the unpaid bill of one customer from another customer who is not legally obligated to pay the bill.

4. There is no legal authority or equitable basis for Duke to transfer the unpaid bill of one customer to the account of another customer who is not legally obligated to pay the bill. Further, such bill transfers create the potential for unauthorized disclosure of one customer's account information to another customer, misunderstandings by customers as to the extent of their payment obligations, and improper denial or disconnection of electric service.

5. For the purpose of identifying the person(s) who are legally obligated to pay for electric service, the definition of "customer" in Duke's service regulations is overly broad and inconsistent with North Carolina contract law.

The Attorney General's Brief offers a lengthy, detailed argument as to why the Attorney General's proposed changes to Duke's service regulations are necessary to make Duke's service regulations comport with the Attorney General's understanding of North Carolina law relating to contracts, fair debt collection practices and public utilities. In his Brief, the Attorney General noted that Regulation XII.8 has its origins in a similar provision that was addressed in connection with the reconnection of service and allowed denial of service for indebtedness of a member of the family at the same premises. The provision was moved to Section XII in 1994 and modified to allow denial of service to a member of the household or business at any premises served by Duke.

The Attorney General observed that Duke applies Regulation XII.8 not only to deny service at the time of application, but also to disconnect service to an existing customer of record if another member of the household was indebted to Duke at the time the application for service was made. It is Duke's practice to transfer the indebtedness from the third party to the customer's bill. Witness Yarbrough testified that Duke sends a letter to the customer prior to making the transfer, notifying him of the third person's indebtedness. If the debt is not paid or a payment arrangement entered into and the customer does not respond to the letter within 10 days, then Duke transfers the bill to the customer's account.

The Attorney General's proposed changes to the current, stipulated Service Regulations are discussed in his Proposed Order and the reworded portions are included in its Attachment A to that Proposed Order.

No other parties responded to the Service Regulations issues raised by the Attorney General.

The Commission agrees with Duke that, as a matter of logic and policy, there is no compelling reason to change the definition of "customer" or the provisions for denial and discontinuance of service. No other party has expressed support for the Attorney General's position. There have been very few complaints from Duke's customers relating to the issues raised by the Attorney General, and the current service regulations have made it easier and less costly for Duke to collect amounts owed by customers.

During the hearing, Duke witness Yarbrough noted that any time customers feel that Duke has not appropriately interpreted any regulation, they have the right to have Duke's interpretation reviewed with the Public Staff. And when there continues to be a dispute, the customer has the right to file a formal complaint with the Commission. The Commission is of the opinion that this set of procedures provides ample protection for Duke's residential customers in the event that Duke fails to apply its existing service regulations in an appropriate manner.

Duke's practice is to deny or disconnect current service to a customer for a past due and unpaid balance for electric service incurred by a member of the customer's household if the delinquent member resides with or will reside with the customer at the time the customer applies for service. In lieu of denial or disconnection of service, Duke will transfer the delinquent obligation to the account of the current customer for collection. The Attorney General asserts that this practice violates North Carolina law because it permits Duke to hold one person liable for payment of goods and services based on an implied contractual obligation where there is an express contract with another person to pay for the same goods and services. The Attorney General cites Vetco Concrete Company v. Troy Lumber Company, 256 N.C. 709, 124 S.E. 2d 905 (1962) as support for this position. In Vetco, the Supreme Court of North Carolina found that a supplier's express contract with a purchaser of materials precluded the supplier from pursuing payment from a third-party lumber company that had used some of the materials. The Court held that, where an express contract exists, an implied contract is precluded with reference to the same subject matter.

The Commission has carefully reviewed the Vetco decision, as well as each of the additional cases cited by the Attorney General.[22] A close reading of each of those cases leads the Commission to conclude that they are inapplicable to the present situation for the following reasons. First, in this proceeding, unlike in those cases, there is an express contract, i.e., the service agreement, rather than an implied agreement that provides for the denial of service if suitable arrangements are not made for the recovery of the bills in question. The service agreement expressly incorporates those sections of Duke's Commission-approved regulations that permit the discontinuation of service to the applicant unless arrangements are made to satisfy the debt of the delinquent obligor into that agreement. Second, in this proceeding, unlike in those cases, the third-party applicant actually receives new consideration in the form of future service in exchange for her agreement to pay the additional expenses.

In each of the cases upon which the Attorney General relies, there is no evidence that the party that breached his duty to pay sought to continue receiving the product for which he failed to pay with the assistance of the party contending before the court that he should not be required to pay the delinquent party's debt. The Commission understands that the Attorney General might dispute this characterization. However, it is beyond contravention that, without the applicant's assistance, the debtor would be unable to receive utility service without making arrangements to pay his past due bill.

The Attorney General has also argued that the applicant should not be responsible for the third-party's debts unless he knowingly assists the debtor in evading his obligation to make payment. It is axiomatic that an individual cannot escape his obligations by being willfully blind to that which is obvious. That is, "[a] man should not be allowed to close his eyes to facts readily observable by ordinary attention, and maintain for his own advantage the position of ignorance." State Farm v. Darsie, 161 N.C. App. 542, 548, 589 S.E.2d 391, 397 (2003), dis. rev. den., 358 N.C. 241, 594 S.E. 2d 194 (2004). Duke's policy places the applicant on notice that she could be responsible for the debts of a third party co-resident when she applies for service. It is thus incumbent upon her to inquire of the potential co-resident to determine if the co-resident owes an outstanding debt to Duke. Should she choose not to make such an

[22] Robinson, Bradshaw & Hinson, PA v. Smith, 129 N.C. App. 305, 498 S.E. 2d 841, dis. rev. den., 348 N.C. 695, 511 S.E. 2d 649 (1998); N.C. Baptist Hospitals v. Franklin, 103 N.C. App. 446, 405 S.E. 2d 814, dis. rev. den., 330 N.C. 197, 412 S.E. 2d 58 (1991); G&S Business Services v. Fast Fare, Inc., 94 N.C. App. 483, 380 S.E. 2d 792, dis. rev. den., 325 N.C. 546, 385 S.E. 2d 497 (1989).

inquiry, she cannot thereafter escape responsibility by pleading ignorance of the co-resident's debt. Moreover, if one accepts the postulate that the applicant has no legal obligation to support the debtor, by definition, the applicant is actively assisting the debtor to evade his responsibility because she has chosen not to make the debtor contractually and legally responsible for his share of the obligation by failing to require the debtor to be a joint applicant for service. If, however, there is an agreement "to share the utility bill between the parties," the applicant has legally agreed to assume the debtor's debt in order to qualify for service since the debtor will only be eligible for renewed service if she makes arrangements to settle his debt with the utility.

In addition to the aforementioned, the Commission believes that Deep Run Milling Company v. Williams, 60 N.C. App. 160, 163, 298 S.E.2d 205 (1982), a case which the Attorney General also cites, is supportive of Duke's position. In Deep Run, the Court of Appeals held that it was appropriate to hold a third-party spouse liable for debts that were legally incurred by her husband when the only express contract was between the debtor/husband and the vendor seeking payment. In that case, the Court examined the record and found that the wife actually received and used the product with knowledge of her husband's delinquency and by her express statements thereafter ensured payment. In that situation, the Court held that it was permissible to allow collection of the husband's express debt from the wife on an implied contract theory. In this case, a Commission-approved service agreement,[23] which incorporates the Service Regulations, provides notice that outstanding debts incurred by a potential household member prior to the execution of the service agreement must be satisfied before service can be provided.[24] Thus, the applicant effectively agrees to satisfy the debt in order to receive service and is thereby properly held accountable.

The Attorney General also argued that Duke's practices violate the North Carolina Debt Collection Practice Act.[25] The Commission determines that the North Carolina Debt Collection Practice Act was not designed to shield a debtor's efforts to fraudulently procure a service to which he is not entitled by using an applicant who will unknowingly become responsible for the debtor's debt. In that situation, the Commission believes that disclosure to the unwitting applicant to prevent her from becoming a victim of the debtor's fraud[26] is authorized.

[23] The utility may only impose such a requirement on the customer by Commission-approved regulation. See Commission Rule R8-22, which provides that "[a]ny utility may decline to serve a customer or prospective customer until he has complied with. . . the rules and regulations of the utility furnishing the service, provided such rules and regulations have been approved by the Commission." (emphasis added.) See also Horton v. Interstate Telephone and Telegraph Company, 202 N.C. 610, 163 S.E. 2d 694 (1932) where the Supreme Court held that a utility could not deny service to an otherwise eligible customer based upon a policy which had not been approved by the Commission.

[24] According to witness Yarbrough, the Commission was provided detailed examples of Duke's collection practices in 1994. See Order Approving Revised Service Regulations, Docket E-7, Sub 541, March 30, 1994.

[25] The North Carolina Debt Collection Practice Act prohibits unreasonable publication of information regarding a consumer's debt. G.S. 75-53.

[26] See the discussion of fraud in State v. Yarboro, 194 N.C. 498, 501-502, 140 S.E. 216, 217 (1927). "The phrase 'in cases of fraud' qualifies the word 'debt'; it signifies fraud in making the contract or in

Finally, the Attorney General argues that Duke's actions in requiring a third party to guarantee the debt of the debtor violates G.S. 22-1, which provides that:

> No action shall be brought whereby to charge an executor, administrator or collector upon a special promise to answer damages out of his own estate or to charge any defendant upon special promise to answer the debt, default or miscarriage of another person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party charged therewith or some other person thereunto by him lawfully authorized.

According to the Attorney General, G.S. 22-1 requires Duke to have a written agreement from the applicant to be responsible for the third-party debt. Neither Duke nor any other party addressed this contention in their Briefs or Proposed Orders.

The Commission is not persuaded that Duke's practice of securing an oral agreement that incorporates terms requiring the applicant to be responsible for the co-resident's debt to qualify for service violates the Statute of Frauds. A written agreement is not required when the main purpose of the promisor is to procure some benefit for herself. Warren v. White, 251 N.C. 729, 112 S.E. 2d 522 (1960). In this situation, the primary purpose of the applicant in guaranteeing the debt of the debtor is not to absolve the debtor of the debt, but to ensure that the applicant qualifies to receive utility service. Thus, the Statute of Frauds does not apply in this type of situation. Similarly, even if the statute of frauds did apply, Duke could simply require each applicant to sign a written agreement which included the guarantee language.

After considering all of the evidence and the arguments in the Briefs and Proposed Orders, the Commission concludes that there is insufficient reason to order any changes to Duke's Service Regulations beyond those clarifications and refinements that are set out in the Stipulation. The evidence in the record demonstrates that the current language strikes an appropriate balance between maintaining the Company's ability to maximize collection efforts from users of electric service and avoiding practices that inappropriately harm any particular customer.

EVIDENCE IN SUPPORT OF FINDING OF FACT AND CONCLUSION NO. 37

The Commission has previously discussed its findings and conclusions regarding the fair rates of return which Duke should be afforded an opportunity to earn.

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attempting to evade performance by the fraudulent concealment or disposition of property or other fraud devised for the purpose of defeating collection of the debt." (Emphasis added.)

The following schedules summarize the gross revenues which the Company should have a reasonable opportunity to collect, and the rates of return which the Company should have a reasonable opportunity to earn, based upon the determinations made herein. As reflected in Schedule I, Duke should be required to reduce its annual level of electric operating revenues by $286,924,000, based upon the adjusted test-year level of operations approved herein for Duke's North Carolina retail operations.

SCHEDULE I

DUKE ENERGY CAROLINAS, LLC

North Carolina Retail Operations
Docket No. E-7, Sub 828
STATEMENT OF OPERATING INCOME
For the Twelve Months Ended December 31, 2006
(000s Omitted)

Item	Present Rates	Approved Change	Approved Rates
Electric operating revenue	$3,971,696	$(286,924)	$3,684,772
Operating revenue deductions:			
Operations and maintenance expenses:			
Fuel used in electric generation	952,776		952,776
Non-fuel purchased power and net interchange	49,248		49,248
Wages, benefits, materials, etc.	1,043,004		1,043,004
Depreciation and amortization	495,499		495,499
General taxes	236,548	(9,583)	226,965
Interest on customer deposits	3,156		3,156
Income taxes	357,645	(108,608)	249,037
Amortization of investment tax credit	(6,213)		(6,213)
Total operating revenue deductions	3,131,663	(118,191)	3,013,472
Net operating income for return	$ 840,033	$(168,733)	$ 671,300

( ) Denotes decrease.

SCHEDULE II

DUKE ENERGY CAROLINAS, LLC

North Carolina Retail Operations
Docket No. E-7, Sub 828
STATEMENT OF RATE BASE AND RATE OF RETURN
For the Twelve Months Ended December 31, 2006
(000s Omitted)

Item		Amount
Electric plant in service, including nuclear fuel		$15,103,463
Accumulated provision for depreciation and Amortization		(6,472,573)
Net electric plant in service		8,630,890
Materials and supplies		394,250
Working capital investment		148,717
Operating reserves		(320,091)
Accumulated deferred income taxes		(1,020,717)
Original cost rate base		$ 7,833,049
Overall rates of return:		
Present rates	10.72%	
Approved rates	8.57%	

SCHEDULE III

DUKE ENERGY CAROLINAS, LLC

North Carolina Retail Operations
Docket No. E-7, Sub 828
STATEMENT OF CAPITALIZATION AND RELATED COSTS
For the Twelve Months Ended December 31, 2006
(000s Omitted)

Item	Capitalization Ratio	Original Cost Rate Base	Embedded Cost Rates	Net Operating Income
		Present Rates – Original Cost Rate Base		
Long-term debt	47.00%	$3,681,533	5.83%	$214,633
Common equity	53.00%	4,151,516	15.06%	625,400
Total	100.00%	$7,833,049		$840,033
		Approved Rates – Original Cost Rate Base		
Long-term debt	47.00%	$3,681,533	5.83%	$214,633
Common equity	53.00%	4,151,516	11.00%	456,667
Total	100.00%	$7,833,049		$671,300

IT IS, THEREFORE, ORDERED as follows:

1. That the Stipulation filed in these dockets on October 5, 2007, is hereby approved subject to the additional decisions set forth in this Order.

2. That Duke shall, as directed by further Order of the Commission addressing specific tariffs developed pursuant to this Order, adjust its rates and charges in accordance with the provisions of the Stipulation and this Order, effective for service rendered on and after January 1, 2008.

3. That Duke shall file within 10 days of the date of this Order a statement setting forth the calculation of the new rate to be used to capitalize the allowance for funds used during construction (AFUDC) which shall become effective on January 1, 2008, based upon the decisions reflected in this Order. Duke shall provide a brief explanation of each item entering into the calculation of said AFUDC rate and shall explain the mechanics of its AFUDC accrual procedures. Such information shall be provided in a format similar to that provided by Duke in its Item No. 24 Response

included in its Form E-1 Rate Case Information Report filed in this proceeding. In addition, Duke shall also file a calculation and the underlying explanation of its currently effective AFUDC rate.

4. That Duke is hereby authorized to implement an adjustable Existing DSM Program Rider (EDPR) as provided in Paragraphs 11F-H of the Stipulation. The EDPR and the Company's DSM deferral account shall be subject to modification or elimination by the Commission, if appropriate, in either Docket No. E-7, Sub 831 or Docket No. E-100, Sub 113.

5. That Duke shall credit all future nuclear property insurance policy distributions to Account 228.1, Accumulated Provision for Property Insurance, unless specifically authorized by the Commission to change such accounting practice.

6. That Duke shall continue to file annual cost of service studies based on both the Summer Coincident Peak (SCP) and the Summer-Winter Peak and Average (SWPA) methodologies.

7. That no portion of any Environmental Compliance Costs directly assigned, allocated, or otherwise attributable to another jurisdiction pursuant to Paragraph 7D of the Stipulation shall be recovered from North Carolina retail customers, even if recovery of those costs is disallowed or denied, in whole or in part, in another jurisdiction.

8. That Duke's actual and proposed modifications and permitting and construction schedule under the Clean Smokestacks Act are adequate to achieve the emissions limitations set out in G.S. 143-215.107D.

9. That Duke Energy Corporation is hereby authorized, on a provisional basis, as part of its compliance with SFAS No. 158, to establish a regulatory asset in Account No. 182.3 with respect to Duke's apportioned share of the funded status of pension and other postretirement benefit plan obligations.

10. That the Public Staff is hereby requested to undertake a comprehensive examination and evaluation of Duke's and Duke Energy's practices and procedures with respect to the costing and funding of Duke's pension and OPEB obligations in a manner consistent with the findings and conclusions as set forth herein, and file a detailed report with the Commission setting forth its findings, conclusions, and recommendations. This report shall be filed not later than nine months from the date of this Order (or such other time as the Commission may subsequently establish by Order), in Docket No. E-100, Sub 112. The Public Staff is hereby authorized, in its discretion and as it deems advisable and necessary, to engage an independent accounting or consulting firm to conduct the examination and evaluation or provide consulting assistance to the Public Staff.

11. That the Commission will, pursuant to G.S. 62-80, reconsider one provision of the Merger Order entered in Docket No. E-7, Sub 795 on March 24, 2006. The Commission will specifically reconsider that provision in Regulatory Condition No. 76 (as discussed in conjunction with Finding of Fact No. 37 in the Merger Order and the Evidence and Conclusions in support thereof) which provides that:

> . . . Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. . . .

The Commission has preliminarily concluded that the provisions of the Merger Order will not produce a fair sharing of the benefits of estimated merger savings between ratepayers and shareholders and that, for that reason, Duke should be authorized to implement a 12-month rate increment rider to collect $80,459,000 from its North Carolina retail customers for the benefit of its shareholders. Pursuant to G.S. 62-80, the Parties to Docket Nos. E-7, Sub 795 and E-7, Sub 828 are hereby given notice and opportunity to be heard in response to the Commission's stated intent to reconsider the specified provision of the Merger Order. Initial comments on this matter on reconsideration shall be filed by all parties not later than Friday, January 11, 2008, and reply comments shall be filed not later than Friday, January 25, 2008. Such comments shall be filed in Docket Nos. E-7, Sub 795 and E-7, Sub 828. The Commission will then enter an Order on reconsideration.

12. That Duke shall establish a 10-year amortization schedule for $29,059,000 of GridSouth costs, and shall begin the amortization in June 2002, without the benefit of carrying charges after that date.

13. That consideration of changes to Rider IS shall be deferred to Docket No. E-7, Sub 831. In addition to the consideration of the new programs proposed by Duke, the issue of what changes, if any, are appropriate to existing demand side management (DSM) and energy efficiency (EE) programs, such as Rider IS, shall be transferred to Docket No. E-7, Sub 831.

14. That the Attorney General's request for amendments to Duke's service regulation in addition to those reflected in the stipulated Service Regulations are hereby denied, and Duke's Service Regulations, attached as Exhibit A to the Stipulation, are hereby approved without change, subject to further Orders of the Commission.

15. That Duke shall file, within 10 days of the date of this Order, a statement setting forth the test-period annualized amount of depreciation expense, with the actual amount and annualization adjustment shown separately, included as an operating revenue deduction under the provisions of the Stipulation. Such information is required to ensure compliance with G.S. 62-133(b)(3) and shall be presented both on a total-company and a North Carolina retail basis.

16. That the Chief Clerk shall serve a copy of this Order on the parties to Docket Nos. E-7, Subs 795, 828, and 829 and Docket No. E-100, Sub 112.

ISSUED BY ORDER OF THE COMMISSION.

This the 20th day of December, 2007.

NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

Bb122007.01

Commissioners Robert V. Owens, Jr. and Lorinzo L. Joyner dissent, in part, with regard to the GridSouth ratemaking treatment.

DOCKET NO. E-7, SUB 828
DOCKET NO. E-7, SUB 829
DOCKET NO. E-100, SUB 112
DOCKET NO. E-7, SUB 795

COMMISSIONER ROBERT V. OWENS, JR., DISSENTING IN PART: I would have flatly rejected Duke's request to recover any GridSouth development costs in the NC retail rates established by the Commission in this proceeding. I strongly believe that the Majority erred with respect to its decision on this issue for several reasons.

First, the FERC is the regulatory agency that caused the GridSouth development costs to be incurred and then a shift in that agency's policy caused the GridSouth project to be canceled. Further, RTO formation and the transmission of power in the wholesale market is under the FERC's jurisdiction. Therefore, Duke should have gone to the FERC to request recovery of all GridSouth development costs from transmission customers before coming to this Commission and requesting that NC retail ratepayers pay over 70% of such costs. Absent even a request by Duke and a ruling by the FERC on this matter, I fail to understand why the Majority feels compelled to include GridSouth costs in NC retail rates.

Second, under any reasonable interpretation of accounting principles and Commission Rule R8-27, Duke should not now be requesting, and the Majority should not now be approving, the deferral and amortization of costs that were incurred prior to mid-2002. In addition, the Majority states that the Commission has generally decided deferral and amortization requests on the basis of whether the costs in question are unusual and material, and considering whether the request is equitable. In discussing materiality, the Majority acknowledges that Duke earned a healthy return in the aftermath of the suspension of the GridSouth project according to the "Quarterly Review" reports published by the Commission. However, what the Majority fails to mention is that Duke earned 13.23% on common equity for the 12 months ended December 31, 2002, that Duke's authorized return in 2002 was 12.50%, and that Duke could have written off all of the GridSouth costs in 2002 and Duke would have still earned in excess of its authorized return on common equity. In my view, this consideration strongly shows that the deferral is not justified on the grounds of materiality and it is clearly not equitable for the rates that are established in this proceeding to provide for the recovery of GridSouth costs because the rates charged in 2002 were sufficient to recover the GridSouth costs.

Third, the Majority goes to great length to explain why its decision to allow deferral of the GridSouth costs is not in violation of the Clean Smokestacks Act of 2002 (the Act). However, I am not convinced by their explanation and I note that even Duke did not advance the theory adopted by the Majority to support its decision with respect to the Act. Further, I would have denied the deferral, amortization, and cost recovery approved by the Majority even if it is not in violation of the Act for the other reasons stated herein.

Finally, given the majority's decision on this issue, I am deeply concerned that the signal has now been sent to Duke that it is far better to disregard the Commission's Rules (that is, by not having sought deferral of the GridSouth costs in a timely manner), and then to later ask forgiveness for having done so, than it is to comply with such rules when doing so would most likely produce an unfavorable result from the Company's perspective. Clearly, Duke should not have deferred the GridSouth costs without first having obtained this Commission's approval, and I cannot, and do not, accept that Duke was not well aware of that fact when it decided to do so, the Clean Smokestacks Act and Duke's alleged misunderstanding of that Act notwithstanding. I would not have, and the majority should not have, condoned Duke's having disregarded the Commission's Rules. Indeed, at the very least, the majority should not have rewarded Duke for having done so, as it has elected to do in this instance.

For these reasons, I dissent with respect to the Majority's decision on the GridSouth issue, but concur with the other decisions of the Commission in this proceeding.

Robert V. Owens, Jr.

Commissioner Robert V. Owens

DOCKET NO. E-7, SUB 828
DOCKET NO. E-7, SUB 829
DOCKET NO. E-100, SUB 112
DOCKET NO. E-7, SUB 795

COMMISSIONER LORINZO L. JOYNER, DISSENTING IN PART: I must dissent from that part of the majority's order that approves a 10-year amortization of Duke's costs to develop the proposed GridSouth RTO, which translates into a $2.9 million operating expense in Duke's cost of service in this case. I believe that the majority's decision is contrary to the Clean Smokestacks Act and to generally accepted principles of accounting and Commission Rule R8-27. I am also of the opinion that the decision deviates from past Commission practices as to deferrals of costs, and, as such, sets a dangerous precedent.

The Clean Smokestacks Act. The majority begins by considering the impact of the Clean Smokestacks Act of 2002 (the Act). This landmark legislation was designed to address the clean-up of coal-fired electric generating plants in North Carolina. The Act requires the utilities involved to undertake significant capital costs necessary to meet the new limitations on emissions imposed in G.S. 143-215.107D. The utilities are allowed to accelerate the recovery of these costs, with 70% of the costs to be recovered through amortization during a rate freeze period. G.S. 62-133.6(b). During this rate freeze -- from June 20, 2002, through December 31, 2007 -- the utilities' base rates shall remain unchanged. G.S. 62-133.6(e). However, consistent with the public interest, the Commission may allow rate reductions if requested by the utilities, G.S. 62-133.6(e)(2), and may allow other "adjustments to base rates, or deferral of costs or revenues, due to one or more of the following conditions occurring during the rate freeze period," and four limited conditions are clearly defined, G.S. 62-133.6(e)(1).

In interpreting the Act, it is important to consider the purpose of the legislation. The legislation was passed while the electric utilities operating coal-fired generating plants in North Carolina were enjoying healthy financial returns and earnings. The intent was to effectively capture some of those returns for the very worthy public purpose of reducing emissions from those coal-fired plants. The purpose of the rate freeze was to facilitate the utilities' environmental clean-up efforts, at a time when they could afford to undertake such clean-up, by restricting rate adjustments -- up or down -- and deferrals -- of both costs and revenues -- to certain circumstances. Some of the exceptions protect the utility and some of them protect ratepayers, but only limited adjustments were allowed for the five-and-a-half-year rate freeze period, during which time the utilities must amortize most of their clean-up costs.

The majority engages in an exhausting analysis of the Act and comes up with a novel interpretation that, until today, has never been revealed. The majority declares that the Act simply does not address the circumstances presented by Duke's request to defer its GridSouth costs. The majority takes the position that "nothing in the statutory language bars the Commission from allowing a rate change after the rate freeze period resulting from costs incurred before the rate freeze period …" I believe that the majority's analysis misses the point.

First, I believe that the rate freeze bars deferrals of costs as well as changes in base rates unless they are specifically excepted and allowed.[1] If the rate freeze was not intended to bar deferrals, there would have been no need to allow certain deferrals in the exceptions in G.S. 62-133.6(e)(1). G.S. 62-133.6(e)(1) allows "adjustments to base rates, or deferral of costs or revenues, due to one or more of the following conditions occurring during the rate freeze period." The fact that <u>certain</u> deferrals are spelled out and <u>allowed</u> by G.S. 62-133.6(e)(1) indicates that the rate freeze applies to deferrals generally and that deferrals <u>other</u> than those allowed are <u>barred</u> by the rate freeze. Duke's present request to defer its GridSouth costs does not come within any of the exceptions that are allowed, and it is barred by the rate freeze.

Second, I see no basis for concluding that costs incurred prior to the beginning of the rate freeze period should be treated differently. There is no explicit statutory language upon which to base a distinction between pre- and during-rate-freeze costs. The language of the statute makes very clear that the allowed exceptions must be based upon <u>conditions occurring during the rate freeze period</u>, but there is no language distinguishing as to <u>costs</u> incurred before or during the rate freeze period. The majority states repeatedly that it is applying the "literal language" of the statute, but a fundamental distinction upon which the majority relies – the distinction between pre- and during-rate-freeze costs -- is not based upon any explicit language in the statute. The majority, in effect, writes into G.S. 62-133.6(e) a broad exception for "deferrals of costs that were incurred prior to the beginning of the rate freeze." No such exception was written into the Act by the General Assembly, and not even Duke believes that there is such an exception in the Act.

The distinction relied upon by the majority also fails to effectuate the purpose of the Act. The majority correctly states the purpose of the rate freeze -- "to require the affected utilities to address all costs incurred during the rate freeze period using revenues derived from existing rates" -- but a deferral of pre-rate-freeze costs and later inclusion of them in post-rate-freeze rates would effectively erode the purpose of the rate freeze and the intent of the Act just as surely as a deferral of during-rate-freeze costs.

The majority's decision, in essence, is "the Act does not address Duke's GridSouth request, Duke could and should have applied for a deferral of the GridSouth related expenditures in June 2002, but that is not a problem." Although it concludes that Duke's request is late, the majority immediately forgives the delay and creates a regulatory asset <u>nunc</u> <u>pro</u> <u>tunc</u> as of June 2002. This forgiveness is no small matter. First, it establishes a retroactive deferral of costs extending back into the rate freeze period, which I believe violates G.S. 62-133.6(e). Second, it completely excuses non-compliance with the majority's own interpretation of the Act (and non-compliance with Commission Rule R8-27) and thereby sets up the operating expense in the test period used in this case. The majority excuses Duke because it "would have been difficult for Duke to know … the time had come to request deferral and amortization" in June 2002. In my opinion, this rationale does not withstand scrutiny. Both generally accepted

[1] The majority begins by stating, "By its explicit terms, the statute <u>precludes</u>…certain cost or revenue deferrals during a rate freeze period…" (emphasis added). Actually, the Act explicitly <u>allows</u> certain deferrals, and I believe that deferrals that are not allowed are precluded.

accounting principles and Commission Rule R8-27 made clear that some new accounting treatment was required as soon as GridSouth was terminated, as discussed below.

The essence of Duke's argument, on the other hand, is "the rate freeze and its exceptions did not allow this deferral request, and this rate case is therefore our first opportunity to present it." Duke's premise is correct, but I believe that its conclusion is wrong. The fact that the rate freeze barred this request does not mean that Duke can simply wait it out. The fact that the rate freeze barred this deferral means that Duke cannot present this claim -- not during the rate freeze and not now. Allowing Duke to defer GridSouth costs that were incurred over five years ago, before the rate freeze, and to now include them in fixing rates for 2008, after the rate freeze, compromises the purpose of the rate freeze and fundamentally changes the equities embodied in the Clean Smokestacks legislation. I do not believe that the General Assembly ever intended such a result.

In short, I believe that the majority's decision violates both the language and the purpose of the Clean Smokestacks legislation. The majority parses the language of the Act and asserts that it does not specifically address the present fact situation, that there is effectively a "hole" in the Act that allows this deferral to pass. While I understand the imperative of finding one, I do not believe that there is any hole in the Act or any uncertainty in its language. If the present situation is not more expressly prohibited by the language of the Act, it is only because no one ever imagined that the Commission would countenance such extraordinary accounting as hoarding an old deferral claim until after the freeze period had expired, which brings me to my next point.

<u>Accounting Principles and Commission Rule.</u> Even if I could accept the majority's conclusion that the Clean Smokestacks Act does not bar deferral of the GridSouth costs, Duke's request is contrary to generally accepted principles of accounting and Commission Rule R8-27, and it should be denied on that alternative ground.

Duke should not be allowed to simply retain its GridSouth costs on its books for years without either writing them off as a loss or converting them into a regulatory asset by an accounting order from the Commission. Since no accounting order was requested, no proper GridSouth regulatory asset was ever created for North Carolina retail ratemaking purposes, and the related operating expense during the test period should be removed from the cost of service in this case.

The majority says that its decision "is fully consistent with … ordinary ratemaking principles." I do not agree. This decision is not consistent with the accounting principles and Rule discussed below, and it is anything but ordinary ratemaking. To provide context, consider a more typical deferral scenario. Suppose that a hurricane requiring extensive rebuilding strikes in Year 1. Suppose further that the utility is experiencing an unusually high return in Year 1 and fears that the Commission might not approve a deferral of the storm damage costs if presented right away. Would the utility be allowed to simply hold its deferral claim until its return drops and then present the claim years later, say in Year 5, when circumstances are more favorable for approval? Certainly not, yet I believe that the foregoing scenario is analogous to the majority's handling of

Duke's GridSouth costs. Circumstances were not favorable for approval in 2002 and Duke did not present its deferral request then, but the majority has allowed Duke to sit on its claim until more favorable circumstances come along. A claim for deferral of costs, once ripe for decision, is not a chip to be held until needed and cashed at the convenience of the utility.

Duke places great reliance upon the January 25, 2001 Declaratory Order issued by FERC, but that reliance is misplaced. As I understand the Declaratory Order, FERC allowed the GridSouth participants to treat their ongoing investments in the project as deferred debits and to accumulate carrying costs, but, because GridSouth did not yet exist and the participating utilities could not record a receivable from a non-existing entity, the Declaratory Order required the participants to record the amount in Account 186 – Miscellaneous Deferred Debits. It was anticipated that once GridSouth was formed, GridSouth would record a payable to each utility and each utility's costs would become a receivable from GridSouth. The Declaratory Order did not pre-approve any rate recovery; it explicitly provided that "petitioners did not request pre-approval for rate recovery and we are not granting it here." FERC could not have authorized a deferral of costs for retail ratemaking purposes, even if it had desired to do so, since this Commission retains exclusive jurisdiction as to retail ratemaking. Events did not unfold as anticipated by FERC, and the GridSouth project was terminated in June 2002. Once the project was terminated, the underlying rationale of the Declaratory Order was no longer valid. The Order had only approved use of Account 186 as a temporary measure until GridSouth was formed. Once it became clear that GridSouth would not be formed, it was no longer appropriate for Duke to maintain its costs in Account 186 and whatever authority the Declaratory Order might have provided to Duke beforehand vanished at that time.

At that time, re-examination of the proper accounting of the GridSouth costs was required. The GridSouth costs were expenses that could have been charged to net income at the time of the GridSouth termination and written off as a loss. The alternative (again assuming no bar in the Clean Smokestacks Act) was creation of a regulatory asset to be recorded in Account 182.3 – Other Regulatory Assets.[2] Under generally accepted accounting principles, nonregulated companies are not allowed to defer spent costs; they must write them off in the fiscal year in which the costs or the loss was incurred. Regulated companies such as Duke are sometimes allowed to defer spent costs from the fiscal year in which they are incurred to later years, provided certain conditions are met. See Financial Accounting Standards Board's Statement of Financial

[2] The description for Account 182.3 – Other Regulatory Assets in the FERC Uniform System of Accounts reads in relevant part as follows:

> 182.3 Other regulatory assets.
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> ….
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> B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts <u>but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.</u> … (Emphasis added.)

Accounting Standards (SFAS) No. 71[3] and Commission Rule R8-27. Costs deferred under SFAS No. 71 are typically referred to as a "regulatory asset." They are not assets in the traditional sense, but they have economic value because of their treatment in the regulatory process. One very significant value is that the amortized expense is kept on the utility's books for an extended period of time, effectively reserving the costs for potential inclusion in rates.

To justify treating the GridSouth costs as a regulatory asset, Duke needed an accounting order from this Commission. Neither the out-dated FERC Declaratory Order nor the regulatory decisions of other jurisdictions can appropriately be regarded as a surrogate. Both accounting principles and Commission Rule R8-27 made clear that an order from this Commission was necessary.

Commission Rule R8-27(a)(2) specifically requires that "electric utilities under the jurisdiction of the Commission must apply to the Commission for any North Carolina retail jurisdictional use of…Account 182.3 – Other Regulatory Assets." Despite its being cited and relied upon by the Public Staff, the majority never addresses Commission Rule R8-27. The majority says that "it would have been preferable for Duke to have signaled to the Commission at an earlier time that it intended to seek a deferral…." In the face of a Commission Rule requiring that the <u>utility must apply for Commission authority</u> to set up a regulatory asset, the most the majority is willing to say is that it would have been <u>preferable for Duke to have signaled the Commission as to what it intended to do</u>. I find this a troublesome stance for the Commission to take vis-à-vis the public utilities it is charged with regulating.

In summary, Duke should have either written off the North Carolina retail portion of its GridSouth costs as a loss or requested Commission approval to defer the amount as a regulatory asset in or about June 2002. Duke did neither; instead, Duke unilaterally elected to carry spent costs on its books for years, contrary to accounting principles and the Commission's Rule. Sanctioning such conduct is, in my opinion, an unwise departure from well-established practices and a bad precedent for the future.

<u>Commission Precedents.</u> Even if I could get past my previous two objections, there is the issue of the Commission's past practices with respect to deferrals of costs. The majority claims that it has evaluated Duke's request under the usual principles applicable to such requests, but I disagree. I believe that the majority's decision represents a significant and unprecedented indulgence in the exercise of the Commission's discretion.

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[3] SFAS No. 71, in pertinent part, provides as follows:

> An enterprise shall capitalize all or part of an incurred cost [footnote omitted] that would otherwise be charged to expense if both of the following criteria are met:
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> a. It is probable [footnote omitted] that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

Although generally disfavored, deferral accounting has been authorized in special instances for costs that are unusual and material and of such magnitude that departure from traditional accounting practices is deemed warranted from the standpoint of fairness and equity to both consumers and shareholders.[4] See Order Approving Deferred Accounting Treatment issued April 29, 1997, in Docket G-5, Sub 369. Over time, the Commission has considered many requests for deferrals of costs, and, despite the variety and range of the requests, examination reveals fairly consistent practices. The majority's present decision goes further: while it articulates the correct standard, it is more lenient than these precedents in significant ways.

First, in the past, the Commission has ordered that amortization begin as of the time the costs or the loss was first incurred (here, that was upon termination of GridSouth in June 2002) and the Commission has generally allowed amortization periods of 5 years or less.[5] Here, the majority has ordered a 10-year amortization. Duke did not request such; Duke requested a 5-year amortization. The majority, on its own initiative, has authorized a period longer than requested, and the effect of its doing so is significant. Approving a 10-year amortization period reduces the operating expense in the test period, but it extends the period of amortization well into the future and thereby creates a test period expense that would otherwise have been hard to sustain. A 5-year amortization beginning in June 2002 would have expired in 2007. There would have been a year's expense in the 2006 test period used in this case, but the amortization would have been almost over at that point, and the test period expense would have been hard to justify from a ratemaking perspective. As a matter of ratemaking, an expiring test period expense representing a unique situation such as GridSouth would have surely been challenged by a normalization adjustment since it would not have represented any ongoing expense.

Second, in the past, the Commission has considered the utility's earnings as an important factor in exercising the Commission's discretion. Costs must be "unusual and material" for a deferral to be considered, and their impact on earnings goes to establishing whether the costs are "material." The Commission has stated that "in considering whether the public interest would be served by the significant departure from fundamental ratemaking principles that would result … it is appropriate, among other things, to consider [the utility's] level of earnings and the effect that deferring, or not deferring, certain storm costs would have on those earnings." Order Granting in Part and Denying in Part Request for Deferral Accounting issued December 23, 2003, in Docket No. E-2, Sub 843.

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[4] Deferral accounting has been allowed for such costs as rebuilding after a hurricane or severe ice storm (Hurricane Hugo in Docket No. E-7, Sub 460; Hurricane Ivan in Docket No. E-7, Sub 776; Hurricane Isabel and the 2003 ice storms in Docket No. E-2, Sub 843; Hurricane Fran in Docket No. E-2, Sub 699), major clean-up costs (manufactured gas plants and transformer sites in Docket No. E-2, Sub 894), and the Year 2000 computer conversion (Docket No. G-5, Sub 369). See also the Commission's discussions of abandoned plants (e.g., in Docket No. E-2, Subs 537 and 333).

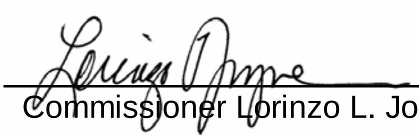
[5] For example, the Commission approved amortization periods of 5 years in Docket No. E-2, Sub 843, in Docket No. E-7, Sub 460, and in Docket No. E-7, Sub 776; 40 months in Docket No. E-2, Sub 699; and 3 years in Docket No. G-5, Sub 369. Longer periods have been allowed for major plant abandonments.

Here, consideration of Duke's earnings works against a deferral,[6] and so the majority dismisses this consideration by stating, without precedent, that a healthy return "alone does not preclude allowance of the deferral request given the unusual nature of the costs at issue here." Apparently, the majority now believes, contrary to the Commission's previous pronouncements, that if the costs are unusual enough, they need not be material at all compared to earnings. At another point, the majority states that Duke's earning do not constitute a bar "given the magnitude of the costs in question and the reasonableness and prudence of the decisions that led to their incurrence.…" Again, in its determination to reach a specific result, the majority has introduced a new standard different from that it traditionally applies.

Finally, the majority says that, as a response to Duke's healthy financial earnings, it has lengthened the amortization period to 10 years. The majority may regard this extension as a sufficient counterbalance, but in fact, as discussed above, the 10-year amortization actually works to Duke's favor by, in effect, "normalizing" a unique test period expense that would have otherwise been about to expire and hard to justify as a matter of ratemaking.

Conclusion. There is an implicit assumption throughout the majority's decision that equity favors Duke. I understand the source of this assumption and am not unsympathetic: GridSouth was a response to FERC mandates, despite widely-held concerns that FERC's policies did not favor the utilities and ratepayers in the Southeast. There are, however, other relevant considerations, and for me the most important consideration of all is the equities embodied in the Clean Smokestacks Act.

The Clean Smokestacks Act was the product of a grand but delicate compromise on the part of numerous stakeholders – the electric utilities, consumer interests, and the environmental community. To the extent the Commission approves a retroactive deferral of costs that was not intended by the parties who negotiated that compromise (and it was clearly not intended by the Public Staff and the Attorney General), the Commission allows Duke to re-write this historic compromise more than five years after the fact. We will never know for sure, but I cannot help but wonder if Duke is just as surprised as anyone by the majority's decision.



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[6] In my opinion, if Duke had requested a deferral order in June 2002, that request would likely have been denied by the Commission on the basis that the Company's earnings were healthy enough to justify charging the GridSouth costs to net income at that time.