

**STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH**

**Docket No. E-2, Sub 1103  
Docket No. E-7, Sub 1110**

In the Matter of	)	
Joint Petition of Duke Energy Progress, LLC	)	COMMENTS
and Duke Energy Carolinas, LLC for an	)	OF THE
Accounting Order to Defer Environmental	)	ATTORNEY GENERAL'S
Compliance Costs	)	OFFICE

The North Carolina Attorney General's Office ("AGO") respectfully submits these comments regarding the joint petition ("Joint Petition") of Duke Energy Progress, LLC ("Duke Progress") and Duke Energy Carolinas, LLC ("Duke Carolinas") (collectively, "Duke Energy") requesting issuance by the Commission of "an accounting order for regulatory accounting purposes authorizing [Duke Energy] to defer in a regulatory asset account (until [Duke Energy's] next base rate cases) certain costs incurred in connection with compliance with federal and state environmental requirements as it relates to Coal Combustion Residuals ("CCRs" or "coal ash")."<sup>1</sup>

**Introduction**

The coal ash costs that Duke Energy seeks to recover are out-of-the-ordinary and very concerning because they may result in large rate increases for consumers. There are important questions that need to be addressed regarding whether all of the costs that Duke Energy seeks to recover were reasonably and prudentially incurred. It would not be appropriate to make important, binding, substantive determinations regarding recovery of these costs in a procedural,

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<sup>1</sup> Joint Pet. at 1.

accounting-related docket. The Commission should ensure that all of the issues regarding coal ash cost recovery will not be resolved or prejudged until there is a complete evidentiary record in the upcoming rate cases. The Commission should direct Duke Energy to record the costs temporarily in the FERC USOA balance sheet asset account entitled Account 186 – Miscellaneous Deferred Debits, or another appropriate account, and to state that the authorization for temporary deferral pending a hearing on the merits does not provide any presumptions in favor of Duke Energy.<sup>2</sup> This will provide all parties to the proceeding with an opportunity to make all legal and substantive arguments during the rate case and its accompanying evidentiary proceedings. It would not be in the public interest for recovery issues to be decided prematurely prior to the rate case.

### **Factual Background**

On 22 December 2008, the failure of a dike that was used to contain coal ash at a Tennessee Valley Authority plant resulted in 5.4 million cubic yards of coal ash waste being released into the Emory River.<sup>3</sup> In 2009, the EPA released its list of forty-four coal-fired power plant waste sites with “high hazard potential.”<sup>4</sup>

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<sup>2</sup> This approach was used by the Commission in Order Denying Request to Implement Rate Rider and Scheduling Hearing to Consider Request for Creation of Regulatory Asset Account, In the Matter of Duke Energy Carolinas, LLC for Approval of Rate Rider to Allow Prompt Recovery of Costs Related to Purchases of Capacity Due to Drought Conditions in Docket No. E-7, Sub 849, issued 2 June 2008 (“2008 Duke Carolinas Drought Accounting Order Request”) at 23.

<sup>3</sup> See, e.g., U.S. Environmental Protection Agency and Tennessee Valley Authority Kingston Coal Ash Release Site Project Completion Fact Sheet, December 2014, [https://www.epa.gov/sites/production/files/2016-02/documents/projectcloseout\\_dec2014\\_factsheet.pdf](https://www.epa.gov/sites/production/files/2016-02/documents/projectcloseout_dec2014_factsheet.pdf).

<sup>4</sup> See, e.g., *EPA list shows dangerous coal ash sites found in 10 states*, June 29, 2009, McClatchy, available at <http://www.mcclatchydc.com/news/nation-world/national/article24543913.html>.

Twelve of these sites were in North Carolina; ten were operated by Duke Energy Carolinas and two by Progress Energy Carolinas.<sup>5</sup>

On 21 June 2010, the EPA solicited comments on the regulation of coal ash, laying out two possible regulatory scenarios.<sup>6</sup> Both involved requiring liners for coal ash ponds and groundwater monitoring; one also required closure of coal ash ponds.<sup>7</sup> On 2 February 2014, as a result of the failure of Duke Carolinas to properly maintain and inspect two stormwater pipes running underneath the primary coal ash basin at its Dan River Steam Station in Eden, a pipe failed and resulted in the discharge of approximately 27 million gallons of coal ash wastewater and between 30,000 and 39,000 tons of coal ash into the Dan River.<sup>8</sup> Duke Carolinas, Duke Progress, and Duke Energy Business Services were charged with criminal violations of federal environmental laws, and on 14 May 2015 they pled guilty to nine counts, involving unlawful discharges and/or failures to maintain coal ash impoundments at H.F. Lee Steam Electric Plant, Cape Fear Steam Electric Plant, Asheville Steam Electric Plant, Riverbend Steam Station, and Dan River Steam Station.<sup>9</sup>

Following the Dan River spill, the North Carolina General Assembly passed the Coal Ash Management Act of 2014, which, among other things,

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<sup>5</sup> *Id.*

<sup>6</sup> Hazardous and Solid Waste Management System; Disposal of Coal Combustion Residuals From Electric Utilities, Part II, 80 FR 21302, 21303 (Apr. 17, 2015).

<sup>7</sup> *Id.*

<sup>8</sup> *United States v. Duke Energy Business Services, LLC et al.*, Joint Factual Statement ¶ 1 (5:15 CR 2, 5:15 CR 67, 5:15 CR 68, May 14, 2015).

<sup>9</sup> *United States v. Duke Energy Business Services, LLC et al.*, Plea to Criminal Information and Sentencing Hearing Before Judge Malcolm J. Howard, 5:15-cr-00067-H, doc. 68; Joint Factual Statement, doc. 67 (May 14, 2015).

required closure of coal ash ponds in North Carolina.<sup>10</sup> The EPA published its final coal ash regulations on 17 April 2015, with an effective date of 14 October 2015.<sup>11</sup>

On 7 November 2014 Duke Energy Corporation filed its Form 10-Q for the quarter ending 30 September 2014, recording an asset retirement obligation (“ARO”) of \$3.423 billion “based upon the legal obligation for closure of coal ash basins and the disposal or related ash as a result of the Coal Ash Act and the agreement with [the South Carolina Department of Health and Environmental Control].”<sup>12</sup> Shortly thereafter, Duke Energy began incurring the expenses for which it now seeks deferred regulatory accounting treatment: “Expenses incurred for state and federal compliance and requested for deferral (January 2015 – November 2016) include \$434.4 million for [Duke Carolinas] and \$291.9 million for [Duke Progress].”<sup>13</sup>

Duke Energy has recorded Asset Retirement Obligations (“AROs”) on its Condensed Consolidated Balance Sheets as of September 30, 2016 in the amount of \$4.5 billion, based on the estimated legal obligation for closure of coal ash basins and the disposal of related coal ash to comply with state and federal environmental requirements;<sup>14</sup> however, Duke Energy states that total actual compliance costs incurred could be materially different from these estimates.<sup>15</sup>

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<sup>10</sup> North Carolina General Assembly S.B. 729, Part II (Aug. 20, 2014).

<sup>11</sup> 80 FR 21302, 21302.

<sup>12</sup> Duke Energy, Quarterly Report (Form 10-Q) at 56, 50 (Nov. 7, 2014).

<sup>13</sup> Joint Pet. at 2.

<sup>14</sup> Joint Pet. at 4-5.

<sup>15</sup> *Id.* at 9.

## Procedural History

On 21 December 2015, Duke Energy sent a letter to the Commission, called “Explanation of Accounting Treatment Related to Coal Ash Basin Obligations.”<sup>16</sup> In the letter, Duke Energy informed the Commission that it had accounted for its ongoing and expected coal ash expenses by recording an ARO, as required by GAAP and Federal Energy Regulatory Commission Uniform System of Accounts and General Instruction No. 25.<sup>17</sup> It further informed the Commission that it had created a regulatory asset account.<sup>18</sup> Specifically, Duke Energy asserted that “[t]he Commission has issued orders allowing the companies to defer all impacts of establishing an ARO until these costs can be considered in future ratemaking decisions.”<sup>19</sup> Duke Energy noted that in addition to accounting for its coal ash-related ARO as required by GAAP, it was also “recording a debt and equity return (‘carrying charge’) on the [ARO] net asset for regulatory purposes.”<sup>20</sup> It is currently deferring the equity portion of the carrying charge “until rate recovery has begun” but had already recorded approximately \$2.7 million as “the debt return” through November 30, 2015.<sup>21</sup>

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<sup>16</sup> Joint Pet., Ex. 1.

<sup>17</sup> *Id.* at 1.

<sup>18</sup> *Id.* at 6.

<sup>19</sup> *Id.* at 2, citing Order Granting Motion for Reconsideration and Allowing Deferral of Costs In the Matter of Duke Power’s Petition for Authority to Place Certain Asset Retirement Obligation Costs In a Deferred Account, Docket No. E-7, Sub 723 (August 8, 2003) (“2003 Duke Power Order”) at 11; and the Order Granting Motion for Reconsideration and Allowing Deferral of Costs In the Matter of Carolina Power & Light Company’s Petition for Authority to Place Certain Asset Retirement Obligation Costs in a Deferred Account, Docket No. E-2, Sub 826 (August 12, 2003) (“2003 Duke Carolinas Order”) at 11 (collectively the “2003 Orders”).

<sup>20</sup> *Id.* at 7.

<sup>21</sup> *Id.* at 8.

Duke Energy stated that authority to defer the costs was not being requested “at that time due to significant litigation and reconsiderations related to CAMA, the now-defunct Coal Ash Management Commission, and numerous other outstanding issues.”<sup>22</sup>

On 28 March 2016, the Commission issued an Order Acknowledging Receipt of Filing and created formal dockets related to the establishment of AROs and attendant regulatory assets associated with coal ash costs. The Commission noted that it was not taking any action to address the accounting method announced by Duke Energy, because Duke Energy had not requested any Commission action.<sup>23</sup> The Commission stated that its order “should not be construed as agreement or disagreement with the substance of Duke’s analysis or the conclusions Duke reaches.”<sup>24</sup>

On 30 December 2016, Duke Energy filed the Joint Petition. In the Joint Petition, Duke Energy requests Commission approval to use Account 182.3 to defer the actual costs incurred,<sup>25</sup> specifically, “to defer to a regulatory asset, until the effective date of new rates from the next base rate case, all non-capital costs as well as the depreciation expense and cost of capital at the weighted average cost of capital for all capital costs” related to activities required to comply with the federal and state regulations.<sup>26</sup> In addition, Duke Energy requests approval to

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<sup>22</sup> *Id.* at 10-11.

<sup>23</sup> Order Acknowledging Receipt of Filing at 1.

<sup>24</sup> *Id.* at 1-2.

<sup>25</sup> Joint Pet. at 13.

<sup>26</sup> *Id.* at 14.

defer a cost of capital on the deferred costs at the weighted average cost of capital.<sup>27</sup>

Duke Energy informed the Commission that it intends to file general rate cases within twelve months of the filing date of the Joint Petition in order to address the prudence and ratemaking effects of the costs.<sup>28</sup>

### Analysis

I. The Significant Factual Issues Raised by the Joint Petition Should Be the Subject of an Evidentiary Hearing.

The North Carolina Public Utilities Act provides that all rates by public utilities “shall be just and reasonable.” N.C. Gen. Stat. 62-131(a). Moreover, all rates must be fair to the consumer. “[T]he Commission shall fix such rates as shall be fair both to the public utilities and to the consumer.” N.C. Gen. Stat. 62-133(a).

There are a number of significant factual issues posed by Duke’s request for cost deferral that require an evidentiary hearing for valid determination. North Carolina law provides that “[t]he Commission shall render its decisions upon questions of law and of fact in the same manner as a court of record.”<sup>29</sup> Because of the number and complexity of the issues posed by the Joint Petition, it is appropriate for the Commission to allow Duke Energy to temporarily record its coal ash costs in the FERC USOA balance sheet asset account 186 (Miscellaneous Deferred Debits) or another appropriate temporary deferral account pending a hearing and final Commission determination as was ordered

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<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 13.

<sup>29</sup> N.C. Gen. Stat. § 62-60 (2016).

in the 2008 Duke Carolinas Drought Accounting Order Request.<sup>30</sup> Here, as then, “an evidentiary hearing is equitable, appropriate, and necessary” to resolve the questions of whether a request to create a regulatory asset is appropriate legally and as a matter of regulatory policy.<sup>31</sup>

The costs at issue are large, complex, and out-of-the-ordinary and need to be determined in a docket where there is sufficient transparency, where the parties have sufficient time to analyze the details of the costs for which Duke Energy seeks to recover and to conduct full and appropriate discovery, and where Duke Energy provides sufficient details on the record for the Commission to make a thorough and appropriate determination regarding the issue. The burden is on Duke Energy when it seeks recovery of such costs, and the Commission needs to give full consideration to the issue in order to protect the public interest.

II. The Commission Should Not Prematurely Reach Decisions on Substantive Cost Recovery Issues.

In two orders entered in 2003, the Commission stated that the predecessors to Duke Progress and Duke Carolinas should seek approval of the Commission prior to changing the accounting for the costs of removal of long term assets (e.g., such as the costs of closing coal ash basins).<sup>32</sup> The 2003 Orders addressed an issue created by a new rule, SFAS 143, adopted by the Financial Accounting Standards Board (“FASB”), which required Progress

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<sup>30</sup> 2008 Duke Carolinas Drought Accounting Order Request at 20.

<sup>31</sup> *Id.*

<sup>32</sup> See 2003 Duke Carolinas Order at 13; 2003 Duke Progress Order at 13-14 (emphasis added); See Joint Pet. Ex. 1 at 2 and fn 1 therein citing the 2003 Orders. SFAS 143 is now known as ASC 410-20, the same accounting rule in play in this matter. See Joint Pet. Ex. 1 at 5.

Energy Carolinas and Duke Power to change the way certain AROs were accounted for under GAAP.<sup>33</sup> FASB had recognized that GAAP accounting and regulatory accounting could differ for AROs, and accordingly authorized utilities to recognize a regulatory asset or liability for the difference between the two accounting approaches.<sup>34</sup> The two companies had filed their petitions seeking permission to do just that, create a regulatory deferred account so that they could “place all income statement impacts arising from the ... adoption of [the new GAAP rule] in regulatory deferred accounts.”<sup>35</sup>

The Commission granted permission to create the regulatory deferred account subject to certain express conditions, including that 1) “the intent and outcome of the deferral process [approved for asset retirement obligation accounting] shall be to continue the Commission's currently existing accounting and ratemaking practices for nuclear decommissioning costs and other ARO costs,” and 2) the utility “shall submit all proposed changes in the cost of removal for all long-lived assets and/or in the accounting for such costs, if any, to the Commission for its approval prior to implementation. Such changes, when submitted, shall be considered in the context of a general rate case or other appropriate proceeding.”<sup>36</sup> The Commission specifically recognized that the cost of removal of assets had been a component of the depreciation rates for both Duke Carolinas and Duke Progress, that costs were being accrued in rates over the useful life of the related assets, and that the treatment of depreciation was

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<sup>33</sup> 2003 Duke Carolinas Order at 1; 2003 Duke Progress Order at 1.

<sup>34</sup> *Id.*

<sup>35</sup> 2003 Duke Carolinas Order at 2; 2003 Duke Progress Order at 2.

<sup>36</sup> See 2003 Duke Carolinas Order at 13; 2003 Duke Progress Order at 13-14 (emphasis added).

not to be changed by the implementation of SFAS 143.<sup>37</sup> The Commission drew a clear line between what was required for GAAP accounting and what the Commission required: “the intent and outcome of the deferral process shall be to continue the Commission’s currently existing accounting and ratemaking practices for nuclear decommissioning costs and other ARO costs.”<sup>38</sup>

On 28 March 2016, several months after Duke Energy filed the 21 December 2015 letter, the Commission issued an Order in which it acknowledged the receipt of the letter and created formal dockets related to the establishment of AROs and attendant regulatory assets associated with coal ash costs. As noted above, the Commission did not take any action to address the accounting changes announced by Duke Energy, observing that Duke Energy had not requested any Commission action. The Commission stated that its action “should not be construed as agreement or disagreement with the substance of Duke Energy’s analysis or the conclusions Duke reaches.”

III. Any Order Granting Duke Energy’s Joint Petition In Whole or In Part, Should Be Without Prejudice to Any Party’s Right To Contest In Future Ratemaking Proceedings the Appropriateness of Recovery of Coal Ash-Related Costs to Ratepayers.

Duke Energy acknowledges that it would be appropriate for the Commission to review its coal ash costs “in broad scope” in a future setting, such

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<sup>37</sup> 2003 Duke Carolinas Order at 10-12; 2003 Duke Progress Order at 11-12. This is one of the factors that distinguishes the Joint Petition from Piedmont Natural Gas’s application for deferred accounting on which Duke Energy relies. Joint Pet. at 14. In the case of Piedmont’s expenses for addressing new US Department of Transportation regulations, the costs were “entirely distinct and different in nature from its historical [operations and maintenance] expenses. In the Matter of Application of Piedmont Natural Gas Company, Inc. for Approval of Deferred Accounting Treatment of Interim Pipeline Integrity Management Regulation Compliance Costs Dockets G-9, Sub 495 and G-21, Sub 457, Order Approving Deferred Accounting Treatment at 1 (2 December 2004). In addition, Piedmont requested the deferred accounting prior to incurring expenses. *Id.*

<sup>38</sup> 2003 Duke Carolinas Order at 12-13; 2003 Duke Progress Order at 12.

as a rate proceeding.<sup>39</sup> The AGO does not oppose postponing this inquiry to a future ratemaking case, and submits that—without limitation—the factors set out below are among those that should be preserved for future review and consideration:

*Reasonableness and prudence.* Among other factors, it is pertinent for the Commission to assess whether the construction, operation and management of Duke Energy's coal ash sites have been reasonable and prudent, as well as whether the clean-up costs were reasonably and prudently incurred.<sup>40</sup> Duke Energy also asks for this issue to be preserved for consideration in future proceedings.<sup>41</sup>

In addition, Duke Energy's deferral request seeks full recovery of coal ash costs from ratepayers.<sup>42</sup> However, the Commission has previously concluded that in some instances it is not appropriate for ratepayers to relieve shareholders of all responsibility for the environmental clean-up of utility sites by transferring such costs to current ratepayers.<sup>43</sup> In the context of deferred accounting requests, this Commission has stated that the full amount of major unexpected expenditures should not fall on ratepayers alone, but that there should be a fair division of such costs between ratepayers and shareholders, taking into account,

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<sup>39</sup> Joint Pet. at 1.

<sup>40</sup> The Commission describes these same factors in its discussion of cost recovery for environmental costs associated with manufactured gas plants in the Order Granting Partial Rate Increase *In the Matter of Application of Public Service Company of North Carolina, Inc., for an Adjustment of its Rates and Charges* issued 7 October 1994 in Docket No. G-5, Sub 327 ("1994 PSNC Rate Case") at 22.

<sup>41</sup> See Joint Pet. at 1.

<sup>42</sup> Joint Pet. at 2.

<sup>43</sup> 1994 PSNC Rate Case at 23.

among other things, whether the utility has achieved a reasonable level of earnings during the period for which it seeks deferred accounting.<sup>44</sup>

*Legal prohibitions on recovery.* Duke Energy states that it does not seek deferral of any costs associated with the Dan River pipe break repair and spill cleanup, and nor will it seek recovery of such costs in future rate recovery.<sup>45</sup> Under North Carolina law, “[t]he Commission shall not allow an electric public utility to recover from the retail electric customers of the State costs resulting from an unlawful discharge to the service waters of the State from a coal combustion residuals surface impoundment.”<sup>46</sup> Under its plea agreements, Duke Energy cannot seek a rate increase based on compliance with the criminal fines, restitution related to the counts of conviction, community service payments, its mitigation obligations under the plea agreement, the costs of the Dan River clean up, and/or the funding of the environmental compliance plans required under its plea agreements.<sup>47</sup> The accounting details are important in this context and, accordingly, whether and the extent to which these types of costs are included in Duke Energy’s request for recovery should be examined in the context of a developed evidentiary record.

*Recovery of carrying costs.* Whether Duke Energy may recover carrying costs (e.g., in the event coal ash costs are amortized, whether it is appropriate for Duke Energy to earn a rate of return on the unamortized balance) is an issue

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<sup>44</sup> 2008 Duke Carolinas Drought Accounting Order Request at 10.

<sup>45</sup> Joint Pet. at 2.

<sup>46</sup> N.C. Gen. Stat. § 62-133.13.

<sup>47</sup> *United States v. Duke Energy Business Services, LLC et al.*, Plea to Criminal Information and Sentencing Hearing Before Judge Malcolm J. Howard, 5:15-cr-00067-H, doc. 68 at 38 (May 14 2015).

that may be contested in the rate proceedings. The Commission has previously disallowed the recovery of carrying costs associated with the clean-up of manufactured gas plants.<sup>48</sup> Here, it is appropriate for the Commission to consider what rate of return Duke Energy should receive in light of the nature of the costs Duke Energy seeks to recover.

*Propriety of recovery in light of cost recovery through depreciation or other methods.* Duke Energy notes that the current rates for Duke Progress include a component for coal ash remediation costs as part of the Cost of Removal included in depreciation rates but does not explain in detail how Duke Carolinas has addressed such costs for recovery over the useful life of the assets.<sup>49</sup> One of the factors that may be contested is the extent to which Duke Energy has already collected some coal ash costs through past rates.

*Appropriate contribution from insurance proceeds or responsible third parties.* Another factor that Duke Energy may need to address is whether insurance or third party sources are or may be responsible to fund or contribute to coal-ash related costs.

### **Conclusion**

The Commission should ensure that all of the substantial issues regarding cost recovery will not be resolved or prejudged until there is a complete evidentiary record in the upcoming rate cases. The Commission should direct Duke Energy to set up a temporary regulatory asset on its books so that all of the factual and legal issues raised by the Joint Petition can be fully reviewed on an

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<sup>48</sup> See 1994 PSNC Rate Case at 23.

<sup>49</sup> Joint Pet. at 5.

evidentiary record and without prejudice to the ability of any party to raise other cost recovery related issues at the rate case.

Respectfully submitted, this the 15<sup>th</sup> of March, 2017.

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**CERTIFICATE OF SERVICE**

The undersigned certifies that she has served a copy of the foregoing INITIAL COMMENTS OF THE ATTORNEY GENERAL'S OFFICE upon the parties of record in this proceeding by electronic mail.

This the 15<sup>th</sup> day of March, 2017.

/s/ Margaret A. Force  
Margaret A. Force  
Assistant Attorney General