

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. E-7, SUB 1181
DOCKET NO. SP-12478, SUB 0
DOCKET NO. SP-12479, SUB 0

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of
Transfer of Certificates of Public)
Convenience and Necessity and)
Ownership Interests in Generating)
Facilities from Duke Energy Carolinas,)
LLC, to Northbrook Carolina Hydro II, LLC,)
and Northbrook Tuxedo, LLC)

**COMMENTS OF THE
PUBLIC STAFF**

NOW COMES THE PUBLIC STAFF – North Carolina Utilities Commission, by and through its Executive Director, Christopher J. Ayers, and, pursuant to the Commission's July 25, 2018, *Order Requesting Comments* in the above captioned docket, respectfully submits the following comments to the July 5, 2018, Joint Notice of Transfer, Request for Approval of Certificates of Public Convenience and Necessity, Request for Accounting Order and Request for Declaratory Ruling ("Petition") filed by Duke Energy Carolinas, LLC ("DEC"), Northbrook Carolina Hydro II, LLC, and Northbrook Tuxedo, LLC ("Northbrook"), (collectively "Applicants") in the above-captioned dockets.¹

In their request, the Applicants state that DEC and Northbrook have entered into an agreement whereby DEC will sell five hydroelectric generating facilities

¹ On August 24, 2018, the Public Staff filed a motion requesting that the dates for initial and reply comments be extended to September 4, 2018, and September 18, 2018, respectively, which the Commission granted on August 27, 2018.

("Facilities"), for which the certificates are deemed to have been issued to DEC, as follows:

- (a) The Bryson Hydroelectric Station, which has a nameplate capacity of 980 kW, is located on the Oconaluftee River in Swain County, and first commenced commercial operation in 1925;
- (b) The Franklin Hydroelectric Station, which has a nameplate capacity of 1,040 kW, is located on the Little Tennessee River in Macon County, and first commenced commercial operation in 1925;
- (c) The Gaston Shoals Hydroelectric Station, which has a nameplate capacity of 8.5 MW, is located on the Broad River in Cherokee County, South Carolina, and Cleveland County, North Carolina, and first commenced commercial operation in 1908;
- (d) The Mission Hydroelectric Station, which has a nameplate capacity of 1,800 kW, is located on the Hiwassee River in Clay County, and first commenced commercial operation in 1924; and
- (e) The Tuxedo Hydroelectric Station, which has a nameplate capacity of 6.4 MW, is located on the Green River in Henderson County, and first commenced commercial operation in 1920.

The Applicants state that the Facilities combined provide approximately 18.7 megawatts of generation capacity, which is less than one percent of DEC's hydroelectric generation, and will not affect DEC's ability to provide reliable service to its customers at just and reasonable rates. The Applicants also state that DEC's

cost of maintaining these older facilities makes it more economical for DEC to sell the facilities than to continue using them to serve DEC's ratepayers.

The Applicants state that on May 15, 2018, DEC entered into an agreement with Northbrook pursuant to which DEC will transfer the Facilities to Northbrook for \$4.75 million, and that the facilities have a current net book value of \$42 million. DEC requested the Commission to enter an order allowing DEC to establish a regulatory asset to defer the portion of the total estimated loss on the disposition of the facilities (calculated as the difference between the sale proceeds and net book value of the Facilities, plant material and operating supplies, transaction-related costs, and transmission-related work required by the sale) that is allocable to North Carolina retail customers (approximately \$27 million), to be amortized over a period of years, and with a return, to be set in DEC's next general rate case.²

The Applicants state that consummation of the transaction is contingent upon the necessary regulatory approvals of the Commission, the Public Service Commission of South Carolina ("PSCSC"), and the Federal Energy Regulatory Commission ("FERC") and, pending such approvals, is expected to close in the first quarter of 2019. Approval of the requested accounting treatment is a condition to closing the transaction, so DEC would have no obligation to consummate the sale if the accounting order is not approved. DEC acknowledges that an accounting order granting the relief that DEC seeks will not preclude the

² DEC indicated in its application that approximately \$1.6 million of transmission-related work will be required by the sale, as well as \$1.0 million in legal and transaction-related costs, and \$220,000 in plant material and operating supplies. In response to Public Staff data requests, DEC indicated that the legal and transaction related costs have increased and now total approximately \$1.3 million.

Commission or other parties from addressing the reasonableness of the deferred costs arising from the transaction in the next general rate proceedings filed by DEC.

In addition, the Applicants request a declaratory ruling that once the Facilities have been transferred to Northbrook, the facilities will be considered new renewable energy facilities pursuant to the North Carolina Renewable Energy and Energy Efficiency Portfolio Standard ("REPS"), N.C. Gen. Stat. § 62-133.8, and that DEC may use any Renewable Energy Certificates ("RECs") purchased from the Facilities for REPS compliance.

Investigation by the Public Staff:

The Public Staff evaluated DEC's application, sent multiple data requests to DEC and Northbrook, and held meetings and conference calls with DEC to evaluate the proposed transaction. In its communications to the Public Staff, DEC indicated that the divestiture of the assets benefited customers through reducing customer risk to increased operations and maintenance (O&M) costs and future capital investments, and minimized future regulatory obligations. The Public Staff reviewed the preliminary present value of revenue requirements ("PVRR") analysis conducted by DEC to compare the option of retaining the facilities with the option of divesting the assets to a third party and purchasing the energy back from the facilities at avoided cost rates. Under DEC's analysis, the divestiture option was more favorable to customers, with the divestiture option showing a PVRR benefit

ranging from [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].

Recent capital expenditures made by DEC in resulted in increased costs and increased the book value of the facilities considerably. In response to Public Staff data requests, DEC indicated that it spent approximately \$10.25 million in 2015, \$6.7 million in 2016, \$883,000 in 2017, and spent or has budgeted approximately \$865,000 for 2018. It is not clear to the Public Staff that at the time those costs were being incurred that DEC sufficiently evaluated the magnitude of expenditures required to keep the facilities operational, as opposed to retiring or selling in their prior condition. While the Public Staff acknowledges that the Commission recently completed its investigation of DEC's most recent general rate in Docket No. E-7, Sub 1146, on June 22, 2018, the Public Staff believes that DEC's proposal to sell the assets is new information that creates special circumstances meriting further consideration of whether it is reasonable to impose the full \$27 million loss on sale of the hydro facilities on ratepayers. The Public Staff seeks to investigate this question further, and requests that it be preserved as an open issue until DEC's next general rate case when the reasonableness of recovery of the deferred costs will be addressed.

The Public Staff also reviewed DEC's analysis underlying its decision to sell the facilities. In October 2017, DEC performed a "non-binding market value test," and obtained non-binding bids as a result of that process. DEC indicated that it reviewed the non-binding offers using the following selection criteria: [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[END CONFIDENTIAL]. Following the initial analysis and screening, a second round of bidding was conducted, which resulted in Northbrook's bid being selected.

The Public Staff evaluated the renewable power purchase agreements between DEC and Northbrook, and found that the avoided cost rates and REC purchase prices were reasonable for the term of the five-year agreement. The Public Staff evaluated DEC's ability to utilize the RECs generated by the facilities (approximately 59,800) for REPS compliance purposes and found that while DEC's September 1, 2017, REPS Compliance Plan filed in Docket No. E-100, Sub 147, indicates that DEC has contracted for, or has plans to procure, sufficient resources to meet its general requirement for the planning period (2017 to 2019), the REPS general obligations in N.C. Gen. Stat. § 62-133.8(b) increase in upcoming years (from six percent (6%) of the prior calendar year's retail sales to ten percent (10%) starting in calendar year 2018, and then to 12.5% in calendar year 2021 and each year thereafter). The Public Staff believes that the avoided cost rates, contract term, and REC purchase price agreed to as part of the transaction and used in the PVRR analysis are reasonable.

Accounting Order:

DEC requested that the Commission enter an order allowing DEC to establish a regulatory asset to defer the North Carolina retail allocable portion of

the sale loss, \$27 million, to be amortized over a period of years, and with a return, to be set in DEC's next general rate case.

Given the apparent benefit at this point to the ratepayers of the overall transaction, the Public Staff agrees with DEC's proposal to create a regulatory asset and amortize it to expenses over a period of time, subject to review in DEC's next general rate case. However, the Public Staff does not agree with DEC's proposal to delay beginning that amortization until that next general rate case. Instead, the Public Staff believes that as with certain other deferrals and amortizations previously approved by the Commission, the amortization should begin in the month in which the asset transfer is completed, subject to reevaluation and adjustment in the next general rate case.

The decision as to when the amortization of a regulatory asset should begin is a matter within the discretion of the Commission. As the Commission has found in previous cases, the proper default position is to presume that the rates approved by the Commission at any given point in time are sufficient to and presumed to recover the annual capital and operating costs incurred by the utility at that time. However, in some cases, as when the purpose of the creation of the regulatory asset (the deferral) is largely to more precisely synchronize the beginning of the recovery of the costs of a large generating plant with the effective date of the rates approved in a general rate case that is largely driven by the costs of that plant being transferred to plant in service as the plant becomes commercially operational, it is considered reasonable for the plant's capital costs to be deferred during the period between the commercial operation date and the effective date of

the rate approved in the case, with the amortization beginning with that effective date. Similarly, in other cases, when the costs underlying the regulatory asset are so large and unique as to make it clearly unfair and unreasonable to assume that existing rates are recovering those costs, it may be reasonable and appropriate for the beginning of the amortization period to be delayed until the effective date of rates (as was the case with DEC's recently approved amortization of deferred coal ash disposal expenditures).

The above notwithstanding, the Public Staff believes that in most cases, even when it is not reasonable to assume that the entire cost underlying a requested regulatory asset is recovered in the rates existing at the time the cost is incurred, and thus deferral and amortization of the cost is appropriate, it is nonetheless not reasonable for the beginning of the amortization of the cost to be delayed until the next general rate case. This approach is most in keeping with the underlying ratemaking policy followed by the Commission in North Carolina; namely, that the utility's regulatory books and records should reflect the actual costs of providing utility service to the ratepayers (including the reasonable amortization of periodically deferred costs), and then it should be up to the utility to decide whether that annual cost of service affects its overall return in a manner that justifies the filing of a general rate case. This approach is also most appropriate when the nature of the underlying cost to be deferred is such that it is best considered in general as a normal part of the cost of conducting utility business.

This approach has been most typically used in cases involving the expenses of storm damage repair expenses. In the most recent example, that of the abnormal level of storm damage expenses incurred in 2016 by Duke Energy Progress, LLC (DEP), which was considered in DEP's most recent general rate case, Docket No. E-2, Sub 1142 (which was consolidated with Docket No. E-2, Sub 1131, the proceeding in which DEP requested deferral of the costs), the Public Staff recommended that the deferred costs approved by the Commission be amortized for regulatory accounting purposes over a ten-year period, beginning in the month the largest storm (Hurricane Matthew) occurred. The Public Staff argued in that case that for storm costs and, in general, other events that cause fluctuations in utility income between rate cases, it is most appropriate and reasonable for the Company to begin amortizing deferred costs into cost of service immediately. The purpose of deferral accounting is not to preserve costs for an indefinite period of time. Only in unusual circumstances, where costs are extremely high and/or extremely unusual, or in cases where a general rate case is pending, and the Commission particularly wants to synchronize the recognition of a deferred costs and the approval of new rates, is the delay of beginning an amortization generally appropriate. The Commission approved the Public Staff's recommendation that the amortization begin in the month that Hurricane Matthew occurred.³

³ In another notable case, that of the treatment of the deferred costs related to the never-operational GridSouth Regional Transmission Organization, the Commission decided, in Docket No. E-7, Sub 828, that amortization of the costs should be considered to have begun in June 2002, the date that the GridSouth participants notified FERC that they had ceased incurring GridSouth costs, rather than at the time of the Sub 828 general rate case (2007), as was proposed by DEC. In its Order, the Commission stated, "[T]he Commission agrees with the Public Staff that, as a matter of

The Public Staff believes that the same rationale that supported the amortization of DEP's deferred storm costs beginning at the time the storm costs were incurred also supports the amortization of the deferred book loss in this case beginning at the closing date of the sale of the hydro facilities. Except as described above, it is most appropriate and reasonable for the Company to begin amortizing deferred costs into cost of service immediately upon their incurrence. Therefore, the Public Staff recommends that the Commission should require DEC to begin amortizing the regulatory asset resulting from the book loss on the sale of the hydro facilities as of the date the sale is closed. Based on its review of the average remaining life of the facilities, the Public Staff recommends that the amortization period for the regulatory asset be set at 20 years, which is comparable to the period of time over which the facilities would have been depreciated if they had remained in service. This amortization period should be subject to reevaluation and adjustment at the time of the Company's next general rate case.

Motion for Declaratory Ruling:

The Applicants also requested that the Commission find that once the Facilities have been transferred to Northbrook, the Facilities shall qualify as new renewable energy facilities pursuant to REPS and that DEC may use any RECs purchased from the Facilities for REPS compliance.

Pursuant to N.C. Gen. Stat. § 62-133.8(b)(2), an electric public utility such as DEC, may meet its REPS compliance requirement through several methods,

ordinary practice, amortization of deferred costs should begin as soon as the relevant regulatory asset is or should be established."

including by “generat[ing] electric power at a new renewable energy facility” or “purchasing renewable energy certificates from a new renewable energy facility.” In addition, the definition of a new renewable energy facility in N.C. Gen. Stat. § 62-133.8(a)(5)(c) includes “a hydroelectric power facility with a generation capacity of 10 megawatts or less that *delivers* electric power to an electric power supplier.” (emphasis added).

The Commission accepted the registration of many of the DEC-owned hydroelectric facilities less than 10 megawatts as renewable energy facilities, but not as new renewable energy facilities, in its July 31, 2009, *Order Accepting Registration of Renewable Energy Facilities* in Docket Nos. E-7, Subs 886, 887, 888, 900, 903, and 904, and its December 9, 2010, *Order Accepting Registration of Renewable Energy Facilities* in Docket Nos. E-7, Subs 942, 943, 945, and 946 (collectively, the “Registration Orders”).⁴ In the Registration Orders, the Commission specifically cited its June 17, 2009 *Order on Public Staff’s Motion for Clarification* in Docket No. E-100, Sub 113, where it concluded that these utility-owned hydroelectric facilities do not, however, meet the delivery requirement of N.C. Gen. Stat. § 62-133.8(a)(5)(c), which requires the delivery of electric power to an electric power supplier, such as DEC, by an entity other than the electric power supplier in order to qualify as a new renewable energy facility.

In this case, the transfer of the facilities to Northbrook will result in the electric power from these hydroelectric facilities, all of which are less than 10

⁴ These Registration Orders included the registrations for Bryson (Docket No. E-7, Sub 887), Gaston Shoals (Docket No. E-7, Sub 943), Mission, (Docket No. E-7, Sub 946), and Tuxedo (Docket No. E-7, Sub 942) as renewable energy facilities.

megawatts in capacity, being delivered to DEC, thereby meeting the statutory criteria to be designated as a new renewable energy facility. As such, the Public Staff recommends that the Commission grant the applicant's requested declaratory ruling.

As part of the Application, Northbrook filed registration statements for each of the hydroelectric facilities as new renewable energy facilities. The Public Staff reviewed the applications and determined that the registration statements contain the certified attestations required by Commission Rule R8-66(b). Therefore, the Public Staff also recommends that the Commission accept the registration statements for the each of the Facilities.

Summary:

In conclusion, the Public Staff recommends that the Commission issue an order that:

- (1) approves the transfer of the CPCN requested by the Applicants;
- (2) directs DEC and the Public Staff to further evaluate the reasonableness of the expenditures made by DEC at the Facilities in the 36 months leading up to the agreement between the Applicants for the sale of the facilities, for consideration in the next general rate case;
- (3) establishes the regulatory asset requested by DEC, with the amortization period starting in the month in which the asset transfer is completed, and using the average remaining book life of the assets (approximately 20 years)

as the basis for the recovery period, subject to reevaluation and adjustment, however, in the next general rate case;

(4) finds that the facilities, upon transfer to Northbrook will be considered as new renewable energy facilities and that the RECs generated by the facilities are eligible to be used by DEC for REPS compliance purposes;

(5) accepts the registration statements filed by Northbrook Carolina Hydro II, LLC, in Docket No. SP-12478, Subs 1 through 4 for the Bryson, Mission, Franklin, and Gaston Shoals facilities, respectively, to be considered new renewable energy generating facilities pursuant to N.C. Gen. Stat. § 62-133.8(a)(5)c.;

(6) accepts the registration statement filed by Northbrook Tuxedo, LLC, in Docket No. SP-12479, Sub 0, for the Tuxedo hydroelectric facility as a new renewable energy generating facility pursuant to N.C. Gen. Stat. § 62-133.8(a)(5)c.;

(7) cancels the registration statements originally issued to DEC for the Bryson, Tuxedo, Gaston Shoals, and Mission in Docket No. E-7, Subs 887, 942, 943, and 946, respectively; and

(8) for any other such action that the Commission deems proper.

Respectfully submitted this the 4th day of September, 2018.

PUBLIC STAFF
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Electronically submitted
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CERTIFICATE OF SERVICE

I certify that a copy of these Comments have been served on all parties of record or their attorneys, or both, by United States mail, first class or better; by hand delivery; or by means of facsimile or electronic delivery upon agreement of the receiving party.

This the 4th day of September, 2018.

Electronically submitted
/s/ Tim R. Dodge