PLACE: Held via Videoconference

DATE: Tuesday, September 15, 2020

TIME: 9:00 A.M. - 12:28 P.M.

DOCKET NO.: E-7, Sub 1214

E-7, Sub 1213

E-7, Sub 1187

BEFORE: Chair Charlotte A. Mitchell, Presiding

Commissioner ToNola D. Brown-Bland

Commissioner Lyons Gray

Commissioner Daniel G. Clodfelter

Commissioner Kimberly W. Duffley

Commissioner Jeffrey A. Hughes

Commissioner Floyd B. McKissick, Jr.

IN THE MATTER OF:

DOCKET NO. E-7, SUB 1214

Application of Duke Energy Carolinas, LLC,

for Adjustment of Rates and Charges Applicable to

Electric Utility Service in North Carolina

Noteworthy Reporting Services, LLC

DOCKET NO. E-7, SUB 1213

Petition of Duke Energy Carolinas, LLC,

for Approval of Prepaid Advantage Program

DOCKET NO. E-7, SUB 1187

Application of Duke Energy Carolinas, LLC,

for an Accounting Order to Defer Incremental Storm

Damage Expenses Incurred as a Result of Hurricanes

Florence and Michael and Winter Storm Diego

VOLUME 23

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T A B L E   O F   C O N T E N T S

E X A M I N A T I O N S

E X H I B I T S

P R O C E E D I N G S

CHAIR MITCHELL: All right. Good morning everyone. It's 9:00. Let's go on the record, please. Any preliminary matters for my consideration before we get started this morning?

(No response.)

CHAIR MITCHELL: All right. Hearing none, we are with the Public Staff and the cross examination of the Doss/Spanos panel. Public Staff, you all may proceed.

Whereupon,

DAVID L. DOSS, JR. AND JOHN J. SPANOS,

having previously been duly affirmed, were examined and continued testifying as follows:

MS. HOLT: Good morning, Chair Mitchell, I have no additional questions for Mr. Spanos.

MR. GRANTMYRE: Good morning. This is Bill Grantmyre, Public Staff. All my questions will be to Mr. Doss.

CROSS EXAMINATION BY MR. GRANTMYRE:

Q. And, Mr. Doss, you probably don't have it in front of you, but on the E-1 filed by Duke Energy Carolinas, Item 34-A, that is a list of the long-term debt, or all the long-term debt on your filing on

September 30, 2019. I'm going to ask you a few questions about that. I don't think you need it in front of you. It's just very general.

But by my calculation, there was $8.8 billion listed of first mortgage bond-taxable debt. Would you accept that, subject to check?

A. (David L. Doss, Jr.) I would be willing to accept that, subject to check. I do not have that exhibit in front of me right now.

Q. Yes. And the total long-term debt listed, less the leases, was -- is $10.8 billion; would you accept that, subject to debt -- subject to check?

A. Yes, subject to check, if that's what it says.

Q. And will you accept that the -- dividing $8.8 billion by $10.8 billion results in 81 percent of the long-term debt being first mortgage bonds; would you accept that math?

A. I can accept the math. I don't have the exhibit in front of me to know the context of the exhibit. So I do accept the math, I just don't know the context, so that's all I can tell you from that.

MR. MARZO: Chair Mitchell, if we're going to ask a number of questions on this exhibit, I understand Mr. Grantmyre may want to do subject to check, but I'd like to see if Mr. Doss can get that exhibit in front of him.

CHAIR MITCHELL: All right. Mr. Grantmyre?

MR. GRANTMYRE: I'm actually done.

CHAIR MITCHELL: All right. Let's proceed, then.

MR. GRANTMYRE: Chair Mitchell, I would refer everyone to Public Staff Potential Cross Examination Exhibit Number 79, and that is pages 2550 and 2551.

Q. Do you have that available, Mr. Doss?

A. If you give me just a minute, we're pulling that.

CHAIR MITCHELL: All right. Mr. Grantmyre, just to be sure we're all looking at the same document, would you describe it, please?

MR. GRANTMYRE: This is the ARO-related coal ash revenue requirements, Company versus Public Staff. It's a two-page exhibit.

CHAIR MITCHELL: All right. Thank you, sir. Let's go ahead and get the document marked.

MR. GRANTMYRE: We would request that

this be identified as Public Staff Doss Rebuttal Cross Examination Exhibit 1.

CHAIR MITCHELL: All right. The document will be marked Public Staff Doss Rebuttal Cross Examination Exhibit Number 1.

(Public Staff Doss Rebuttal Cross Examination Exhibit Number 1 was marked for identification.)

Q. Do you have that available, Mr. Doss?

A. I do have that available now; yes, sir.

Q. Now, you would agree that this is for Duke Energy Carolinas?

A. Yes, this is for Duke Energy Carolinas.

Q. And the title is "ARO-related coal ash revenue requirements, Company versus Public Staff"?

A. Yes, that's what the exhibit says.

Q. And right below it, it says "Summary for DEC includes differences due to imprudence, disallowances, and equitable sharing"?

A. Yes, that's what it says.

Q. And I represent to you that this was prepared by Mike Maness, Public Staff director of accounting.

Will you accept that, subject to check?

A. I can accept that.

Q. Now, have you -- have you looked at this exhibit before today?

A. No, I have not.

Q. Would you accept that this exhibit shows the difference between what the Public Staff says will be the annual revenue requirements and what would be the annual revenue requirements under the Duke five-year amortization plus a return?

A. Well, I can kind of digest what I can right now from looking at the document. I see that it has a column for the Public Staff recommended revenue requirement, I see that. There's another column for the Company proposed revenue requirement, and it does say including return on rate base and shows a difference.

Q. And the last column over shows the cumulative difference; is that correct?

A. Yes, that is what it shows.

Q. And we'll come back to page 1, but on page 2, approximately during the middle of the page, this shows a settled rate of return pretax; do you see that?

A. I do see that.

Q. And it basically uses the stipulation numbers, would you agree, 52 percent common equity?

A. It shows 52 percent common equity.
Q. And 9.6 ROE?
A. That's what it shows.
Q. And debt cost of 4.27 long-term debt?
A. Yes, that's what it shows.
Q. And, of course, those numbers would only apply to the Duke Energy Carolinas numbers because the Public Staff did not include any return in its calculations; will you accept that?
A. Could you ask that again, please?
Q. The return number, 9.6, and the common equity ratio and the long-term debt really only applies to the Duke Energy Carolinas five-year return; would you accept that?
A. I recognize that 52 percent, I recognize the 9.6 percent. I don't know how those figures may have been included in any calculations from our rates team at Duke Energy Carolinas or how they might have been included in any calculations from the Public Staff.
Q. Okay. Now, let's go back to page 1. It says "the cumulative difference," the last column.
And you see as we go down, it's $244 million rounded; would you agree with that?
MR. MARZO: Chair Mitchell, I might

object. I realize that North Carolina's a wide-open cross state, but I think we're getting far afield from what I believe Mr. Doss' testimony is about. These seem like questions that are for Jay McManeus and not Mr. Doss. I'm wondering if this is the right witness for these questions.

CHAIR MITCHELL: All right. Mr. Grantmyre, will you let me know where you're going with these questions?

MR. GRANTMYRE: I'm trying to establish -- first of all, he's the director of property accounting, and we're trying to establish what the difference is between -- and we're dealing with coal ash now. I'm trying to establish the difference between the Public Staff's coal ash position and the Company's coal ash position, and the impact on the ratepayers through the revenue requirement. He is an accountant, and this is simple math.

MR. MARZO: It sort of makes my point, Chair Mitchell, that we have revenue requirement witnesses, which is Jane McManeus, that could have been asked these questions should, in fact, Mr. Grantmyre wanted to ask these questions. Just for efficiency, Mr. Doss' testimony is not focused on these areas. I realize that Mr. Grantmyre may want to ask these questions, but they seem inappropriate for this witness.

CHAIR MITCHELL: All right. Well, Mr. Grantmyre, I would ask that you proceed -- I'm going to allow the questions to proceed, Mr. Grantmyre. Please move efficiently. And we recognize the witness' credentials and the witness -- that the witness will answer to the best of his abilities, and we'll give his responses the weight that they're due. Mr. Grantmyre, please proceed.

Q. Now, you see at the bottom of the -- the difference column at the bottom, it says total. The difference over time would be $168 million of revenue requirement greater for based on Duke Energy Carolinas' methodology?

A. That is what this schedule shows.

Q. And I direct you to Public Staff Potential Cross Examination Exhibit 80. And this is ARO-related coal ash revenue requirement differences compared to increased financing costs.

A. I have that exhibit in front of me.

MR. GRANTMYRE: And we would ask that this be identified as Public Staff Doss Rebuttal Cross Examination Exhibit Number 2.

CHAIR MITCHELL: All right. The document will be so marked.

(Public Staff Doss Rebuttal Cross Examination Exhibit Number 2 was marked for identification.)

Q. And do you recognize the first column, column A, that lists the long-term debt issuances?

A. I see column -- yeah, I see column A.

Q. And the footnote says -- will you accept, subject to check, that from the DEC corrected E-1, Item 38, line 14, filed on February 14, 2020?

A. I accept that. But again, I'm not familiar with this exhibit, or the footnotes, or really anything here.

Q. Well, would you accept just looking at it the multiplication that five basis points based on that debt would come out to $500,000 a year in additional interest costs?

A. I accept that --

Q. Column C.

A. I accept that that is what this schedule shows.

Q. And the total after three years of each of the three years would be $1.6 million; will you accept that?

A. That is what the schedule shows.

MR. MARZO: Chair Mitchell, I just renew my objection to the exhibit, and same objection to both exhibits.

CHAIR MITCHELL: All right. Your objection is overruled.

Q. Now, with regard to moving down the page, this is the cumulative, column D, E, and F.

And you see, don't you, after three years the cumulative additional interest, $1.6 million under column D?

A. I see the $1.6 million.

Q. And the cumulative revenue requirement difference, that is the savings, is 2.43 -- or $2.44 million?

A. I -- you said 2.44? I see a 244. 244?

Q. Yeah, I'm sorry. $244 million, yes.

A. That is what this schedule shows.

Q. Now, going to the second page, if we could, would you read the top part, production of annual revenue requirement versus additional interest?

A. That's what I see at the top of page 2 on this schedule.

Q. Now, would you accept that the column G is the revenue requirement difference that's really taken from column E on page 1?

A. I see that those are the same numbers from column E on page 1.

Q. And that column H is also the same numbers as column D on page 1?

A. (Witness peruses document.)

Yes, I see that.

Q. And simple subtraction math, if we subtracted column H from column G, would you agree that that comes out to be column I?

A. That appears to be what the schedule is doing.

Q. And would you accept, if we added up after three years, the additional revenue requirement or the reduction of revenue requirement by the Public Staff's method would be $241 million?

A. I don't see $241 million.

Q. Okay. It's not on the schedule, but adding the $86 million, the $80 million, and $75 million, would you accept -- I now this is Grantmyre math, but it is what it is.

A. If you added those numbers up and they come to that number, then I would accept that subject to check. I have no understanding really of what those numbers mean or really the basis underlying the calculations.

Q. Okay. Now we're going to move to your testimony and make your attorneys happy.

On page 3, Mr. Doss, you state that Public Staff witness Maness incorrectly asserts Duke has chosen a ratemaking treatment that accounts for coal ash costs as deferral of expenses that otherwise would be written off.

Do you accept that that's basically what you say?

A. I'm looking at page 3 of my testimony, and yes, I -- those are the words I have in my testimony. I'm not sure I call -- that you quoted it exactly, but I see that.

Q. It's not an exact quote. It's a summary.

A. Okay. I see.

Q. And, now, isn't it true that Duke Carolinas chose to petition for deferral of the coal ash costs?

A. Well, Duke Energy Carolinas chose to follow the direction of the Commission. And the Commission's order in 2003 -- I believe it was Sub 723, it was the 2003 order related to AROs -- the Commission directed Duke Energy Carolinas to defer the impacts of the adoption of FAS 143 at the time, and to come back to the Commission later to address it for ratemaking purposes.

So when you say "chose," I prefer to think of it as an obligation. You know, we -- we choose every day to follow the orders and directions of the Commission as well as financial accounting standards board in my profession accounting, or the Federal Energy Regulatory Commission's Uniform System of Accounts. We choose to follow those guidelines every day. I prefer to think of that as an obligation as opposed to a choice. It's not really a practical choice.

Q. Well, in 2003, Duke Carolinas petitioned the Commission for approval to defer it; isn't that correct?

A. Yes. In 2003, Duke Energy Carolinas did petition for approval for that.

Q. Now, if these costs had not been deferred, wouldn't they not be written off to expenses?

A. Could you be more specific about the costs you're referring to.

Q. If the coal ash remediation costs had -- the ARO costs had not been deferred, isn't it true that they would have been written off to expense?

A. If they had not been deferred and in accordance with the Commission's orders, they would have been expensed.

Q. Now -- so, therefore, if they had not been deferred and you had not had a rate case, then Duke Energy Carolinas would not have been able to recover these costs in rates; isn't that true?

A. Well, I think what's true is that, if you go back to 2003, we were directed to defer these costs from the accounting entries that were associated with the adoption of FAS 143 ARO accounting. And in that order, the Commission recognized, and the Public Staff supported, and the Commission approved deferral of those impacts until they could be considered in a future rate proceeding.

Q. Now, would you agree that the use of ARO accounting under GAAP in ASC 410 is for financial reporting purposes?

A. Well, it's for financial reporting purposes and for the recording of the impacts on Duke Energy Carolinas' books.

Q. And would you agree that accounting for all retail ratemaking can be -- can differ from GAAP accounting, which is for financial reporting purposes?

A. Well, to be clear on that, when you say "can differ from GAAP accounting," our books and records are fully in compliance with GAAP accounting. So GAAP accounting actually recognizes that there can be overlays to GAAP accounting to recognize that there are impacts of ratemaking on the books and records.

So when you say that, I want to be careful to make it clear that Duke Energy's books and records are completely in compliance with generally accepted accounting principles.

Q. Now, isn't the difference that can be reconciled by deferring costs to a regulatory asset for ratemaking purchases?

A. I'm sorry, could you give me that question one more time, please?

Q. Isn't the difference -- the difference between GAAP and ratemaking accounting can be reconciled by deferring the costs to a regulatory asset for ratemaking purposes? Isn't that what you've done here is ask for a deferral to a regulatory asset for ratemaking purposes?

A. And when you say what we've done here, where is here?

Q. Well, you've applied for a deferral, correct?

A. In which case are you talking about?

Q. Haven't you -- isn't the case in front of us a deferral to the coal ash costs?

A. Well, the -- I think the case in front of us is for the recovery of a previously authorized deferral.

Q. Now, isn't it true, under ARO accounting, only costs for normal operations are included, not costs for improper operations?

A. I'm sorry, Mr. Grantmyre, could you repeat that one more time, please?

Q. Under ARO accounting, isn't it true that only costs from normal operations are included, not costs for improper operations?

A. That is, I think, an accurate summary of the -- of the regulations under ARO accounting.

Q. And isn't that why the costs of the remediation of the Dan River spill are not part of the

ARO costs?

A. That's accurate, yes.

Q. And what about the extraction well and treatment costs at Belews Creek where there was groundwater exceedances violations, wouldn't that be excluded from ARO accounting costs?

A. I'm not familiar with that one offhand.

Q. Excuse me, I'm moving on here.

Now, isn't it correct that, in the absence of the Commission approving deferral of the ARO costs, those costs already would have been written off to expense?

A. And which approval are you speaking of, please?

Q. The approval of the ARO cost -- ARC costs in this case. ARO costs in this case. I'm sorry.

A. I want to be -- I want to be clear I understand which costs you're talking about. You're talking about the costs for the period from January '18 through January 2020?

Q. Yes.

A. And those costs -- to be clear, those were approved for deferral treatments in the last case. And if for some reason the Commission were to decide that they had -- they were not, you know, prudently or reasonably incurred by the Company and they were to be disallowed, those would be expensed.

Q. And they would have been written off; if they had been expensed, it's passed, correct? You would not have recovered it in rates?

A. Absent the Commission's directives to defer those costs, they would have been written off.

Q. Isn't it true that FASB and FERC standards require the recording of ARC costs in the property, plant, and equipment account?

A. That is correct.

Q. And that doesn't necessarily mean that the property is used and useful for ratemaking purposes, does it?

A. Well, in my testimony, it's my position I believe that they are used and useful.

Q. But just because FASB and FERC standards require it in property accounts, ratemaking for ratemaking purposes, the Commission in North Carolina is not bound in any way that that's used and useful; would you agree to that?

MR. MARZO: I would object to the extent, Commissioner -- Chair Mitchell, that that's asking for a legal conclusion. If he's just asking Mr. Doss' position on used and useful as a nonlawyer, then it's fine, but I assume the question was asking legally.

CHAIR MITCHELL: All right. Mr. Marzo, we recognize the witness is not an attorney. I'll allow the question to proceed, give it the weight -- we'll give his response the weight that it's due.

THE WITNESS: Mr. Grantmyre, I'm sorry, could you ask the question again, please?

Q. Would you agree that, although FASB and FERC standards require the recording of ARC costs in property, plant, and equipment, that the Commission is not bound by that as far as being property used and useful for ratemaking purposes?

A. Well, I am not an attorney, so I don't know what the Commission is bound by. It's my opinion that those costs are used and useful. And I might add that, in our previous Duke Energy Progress case as well as the previous Duke Energy Carolinas case, I believe the Commission agreed that those costs were used and useful.

Q. And when Duke created the ARC on its books, did you record only the amount of costs expended to date, or did you include estimated future costs of coal ash closure?

A. In compliance with the FERC and GAAP requirements, we are required to record the full estimate of the future costs.

Q. But you would agree that estimated future costs are not presently used and useful, are they?

A. The -- those costs, when they're initially recorded, essentially -- a noncash entry when it's initially recorded -- and again, used and useful is not a definition that's in the accounting books and records, it's a legal definition. So I don't know how to define it that way, but I'm describing the way the accounting works and the way the entries work when we do record those amounts initially.

Q. Now, I'm going to read a statement for you, and I'm going to break it down. It's -- sentence by sentence, it's a direct quote.

Would you agree that generally regulators ignore ASC 410 for ratemaking purposes?

A. I don't know about generally. I know that -- you know, I'm familiar with this Commission's 2003 order and how they wanted us to defer those impacts.

Q. Now, I refer you to pages 18 to 20 of your testimony, and I'll paraphrase it. You say that the Savoy letter and the Duke petition put the parties on notice about ARO accounting, and the Public Staff did not object.

Does that basically summarize what you say there?

A. I think that's a fair summary.

Q. Now, isn't it accurate to say that the Public Staff supported deferral only on the condition that rate recovery would be preserved as an issue for the rate case?

A. I don't recall the Public Staff's exact words.

Q. But you would agree that they did not agree that it would be in rate base; is that correct?

A. I'm sorry, could you repeat that question one more time?

Q. Would you agree the Public Staff did not agree or accept that the ARO costs should be in rate base?

A. I'm trying to recall what the Public Staff's position was on that. And again, rate base is not an accounting term. It's not an account that I report to.

So as the accountant, I'm not exactly sure what their position as far as how it should be treated for rate base purposes.

Q. Now, would you agree that Duke's own petition then specified that ratemaking treatment of the deferred costs would be reserved for subsequent rate cases?

A. I think that's accurate.

Q. Excuse me. Let me see if I have any more questions.

And you testified earlier the terms used and useful -- you would agree, would you not, or are you aware that that's a statutory term under G.S. 62-133?

A. I am aware that it is a statutory term.

Q. And used and useful does not apply to operating expenses; would you agree to that?

A. I don't know if that's the case. I know that it applies to property.

Q. Now, with regard to coal ash costs such as dewatering ash, excavating ash from impoundments, and transporting it by truck to a rail, third-party landfills, in your opinion are those costs in the nature of operating expenses or are they in the nature of utility plant?

A. Well, the -- for the accountants, we follow -- as I've stated before, I mean, we follow the guidelines that are provided in GAAP and in FERC. And those guidelines, if we determine these costs qualify for ARO accounting treatment, it's very clear that they're capital costs.

Q. For financial reporting purposes; isn't that correct? They're capital costs for -- you're saying for financial reporting purposes?

A. That's correct. Under both GAAP and FERC, it's very clearly identified as a capital cost to be recorded as part of the property, plant, and equipment to the asset that gave rise to the obligation.

Q. Now, are you aware that under Commission rule R8-27(a)(1), that the Commission's orders really supersede FERC's Uniform System of Accounts for retail jurisdictional purposes; are you aware of that?

A. I'm somewhat familiar with that. It sounds familiar. It sounds like a legal-type question, maybe, but I'm familiar with that rule.

MR. GRANTMYRE: Chair Mitchell, I have no further questions.

CHAIR MITCHELL: All right. Thank you, Mr. Grantmyre. Attorney General's Office?

CROSS EXAMINATION BY MS. FORCE:

Q. Good morning, Mr. Doss and Mr. Spanos. My name is Margaret Force. I'm with the Attorney General's Office. I'm going to try to leave my microphone on active, but if we have problems I'll start switching on and off. Most of my questions are going to be for you, Mr. Doss, and I'd like to follow up first on a couple of things that you talked to Mr. Grantmyre about. All of my questions have to do with the coal ash cost recovery.

You were talking first about when you were talking about used and useful. I want to see if we can clarify.

When we're talking about the asset retirement obligation having to do with the closure of the ash ponds and disposal of the CCR, the coal combustion residuals, that's distinguished from some of the costs that Duke incurred to convert to dry ash handling and to take care of water treatment at the various plants; am I right about that?

A. (David L. Doss, Jr.) I think that's an accurate summary.

Q. And so for accounting purposes, Ms. McManeus talked about ARO versus non-ARO.

When we're talking about the ARO costs, we're talking about the ones that had to do with closure of those ponds and disposal of the CCR, right?

A. That's correct.

Q. Okay. Am I right that, then, those -- the closure of those ponds is at the end of the use of those ponds, and that they -- at many of those plants, the plants that generated electricity using that coal ash over many decades are no longer in use?

A. Some of the plants are no longer in use, some are in use.

Q. Okay. Fair enough. And you talked about costs that are disallowed, if the Commission disallows costs, and you also mentioned prudence. But there are many costs that the Commission examines to determine whether they're appropriate to include in a test period, whether they're prudent or not? Would you agree with me, whether they're normalized, how they attribute to the service that's provided in North Carolina versus other jurisdictions and a number of different ways that a costs may be categorized before they're included?

A. I certainly would agree generally that the Commission, Public Staff, and others are reviewing the costs for reasonableness and prudence.

Q. And reasonableness is not exclusively prudence, then; would you agree?

A. I just -- I've seen it, you know, in statutes, reasonable and prudent costs, so --

Q. Okay.

A. -- there's probably a difference perhaps between the two, yes.

Q. Okay. Now, you've described in your testimony on a number of pages the GAAP, and FERC, and other accounting treatment used by the North Carolina Utilities Commission and how that relates to how it's recorded on -- in the records for Duke Carolinas, right?

A. Correct.

Q. And we've had some questions in the case about how costs are accounted for under ARO accounting versus accounting that might be cost of removal or depreciation. And I'd like to walk through some of the history of that with you.

And first of all, just to clarify, when we're talking about an asset -- a legal asset retirement obligation, is a legal obligation associated with long-lived tangible assets that are reported on financial statements; does that sound like a fair description?

A. It's -- it's associated with long-lived tangible assets; that's correct, that are being retired.

Q. And there can also be nonlegal retirement obligations that are used in ratemaking for depreciation and cost of removal; is that right?

A. That's correct.

Q. Okay. But I think you've said, and maybe -- I think I understood it correctly that they shouldn't be double-counted; you shouldn't count them both ways?

A. I don't think they should be double-counted.

Q. Okay. Duke filed a petition that you've talked about a little bit in your responses to Mr. Grantmyre, and it was a petition for an accounting order prior to the last Duke rate case. And that -- I'd ask you to turn to that petition, itself. And it's been admitted as AGO McManeus/Speros Cross Exhibit 1. It's also -- if you -- if it's easier to find in the exhibits that the AGO submitted at Number 43. Those are probable cross exhibits.

A. (Witness peruses document.)

I'm sorry, I do have that exhibit.

Q. So if you have the AGO probable cross exhibits, it was number 43; do you have that?

A. I do have that, yes.

Q. Okay. If you look at it, would you agree with me that that's the petition that Duke filed for Duke Energy Progress and Duke Energy Carolinas on December 30, 2016?

A. Yes.

Q. Okay. And that was to request approval to defer all costs relating to the obligation to close ash basins and remove CCR, right?

A. Correct.

Q. And that included a request for deferral by Duke Carolinas of a total of $2.1 billion estimated for the ARO; is that right? I'll refer you to paragraph 11 on page 9 if you're not sure.

A. (Witness peruses document.)

Q. Is that right?

A. Yes. I see that number that you said.

Q. Okay. That's gone up some since then, the estimate; would you agree with me?

A. I think that's probably right.

Q. And the petition also sought permission to defer the actual expenditures of $424.4 million made between January 21, 2015, and November 30, 2016, correct? That's paragraph 13. Is that right?

A. Yes. I see 400 -- I see the $434.4 million that you quoted, yes.

Q. Did you say 434? I have it wrong in mine.

A. $434.4 million?

Q. Okay. I have a typo in my notes. Okay. The petition indicates that the Commission issued an order in 2003, and you've referred to that in your conversation with Mr. Grantmyre. And that that 2003 order authorized the deferral of the ARO-related amounts, right? And it says that in footnote 2 in the petition?

A. (Witness peruses document.)

Yes, that's footnote 2 in the petition.

Q. Okay. I'd like to look at that 2003 order with you, please. And I don't know how you have them in your notes, but that was AGO Exhibit 40 that was -- or potential cross examination exhibit, and it's already been admitted as AGO McManeus/Speros Cross Exhibit 2; do you see that? Are you there?

A. I do see that. Yes, I have that.

Q. Okay. Good. If you look at page 1 toward the bottom, it says that Duke indicated at that time that the only significant ARO at the time was to decommission radiated portions of nuclear plants and environmental cleanup at Belews Creek, but others may exist, right?

A. I'm sorry, are you on AGO Exhibit 40?

Q. Yes. And that's -- that document, are you looking at what's captioned -- well, the order granting motion for reconsideration and allowing deferral of costs?

A. Yes, I am. And I'm sorry, what portion of that page?

Q. Sure. I didn't give you good directions. If you look down, there's background, in the second paragraph, toward the end of that paragraph. I have paraphrased. I didn't read it. But it says that Duke indicate -- but I'm saying that the indication from Duke was that the only significant AROs at the time that this was being considered was to decommission radiated portions of nuclear plants and environmental clean up at Belews Creek, but that others may exist, right?

A. Yes, that's what's included in it.

Q. Okay. And then on page 2, in the first full paragraph, if you turn with me, it says that when an

ARO liability is recorded, a corresponding asset is recorded on the firm's books as part of the associated tangible asset and depreciated over the life of the associated long-lived asset. It says that, right?

A. Correct.

Q. And that sounds like the principle that you referred to in your testimony on page 10 where you describe FERC accounting and say that asset retirement costs are being depreciated over the useful life of the related asset; is that right?

A. Yes, that's consistent with that.

Q. Okay. So if you turn, then, to page 4, and there's a paragraph there that starts "finally Duke commented that," and if you look down to the second sentence, it says that -- it indicates that Duke gave some examples of nonlegal asset retirement obligations. And those include removal of -- excuse me, costs of removal of distribution, transmission, and nonnuclear generation facilities, correct?

A. Yes.

Q. All right. Let's turn to page 10, at the bottom of the page, and over onto page 11. And reading from that last incomplete paragraph there, would you agree with me it says:

"Depreciation expense" -- I don't know -- okay.

"Depreciation expense, which, in part, is a function of depreciation rates, was included as a component of the Company's North Carolina retail cost of service established in the context of the Company's last general rate proceeding. Consequently, the recovery of that expense, which includes the cost of removal, is now provided for in the rates and charges Duke is authorized to charge for its sales of service with respect to North Carolina retail operations. Consistent with the economic consequences of that regulatory treatment, the cost of removal is accrued and recognized as an operating revenue deduction over the useful life of the related assets, rather than waiting to record the expense until the assets are actually removed and the related costs actually paid."

Is that what it says? Did I quote that correctly?

A. Yes, that's what it says.

Q. Okay. So there's a third point that -- there's several points here, but there's another point that indicates the intent of the 2003 order was that any change in accounting would need to be submitted for approval and addressed in a general rate case or other appropriate proceeding before implementation; would you agree with me?

A. I'm reading this, and that any change in the accounting for cost of removal specifically. Is that what you're reading from?

Q. If you -- sure. And if you look at the next paragraph, the last sentence, does it not say:

"The Commission is of the opinion and so concludes that the Company should be and is hereby explicitly placed on notice that any proposed changes in the cost of removal for long-lived asset and/or any accounting of such costs must be submitted to the Commission for its approval in the context of a general rate case or other appropriate proceeding prior to implementation," right?

A. Yes, that's correct. I'm sorry, when you summarized it a minute ago, I thought you did not -- you were not specific to cost of removal. That sentence appears to me to be very specific about the cost of removal.

Q. Sure. Okay. And I want to go back to the first part of that quote that we just started with on page 10.

It says that the cost of removal was included in the Company's last general rate case; does it not say that?

A. It does say that, yes, here in 2003.

Q. Right.

A. At the -- whatever -- whatever rate case or rates were in effect as of 2003, I think that's what it's -- what it would have been referring to.

Q. Okay. And actually, that's where I was going. This was in 2003.

Would you agree with me that the last rate case in North Carolina, as of 2003, had actually been filed by Duke in E-7, Sub 408 in 1986? That was the case that was appealed, and remanded, and appealed, and remanded, and all issues were finally resolved in 1992, but the rate case was actually filed in 1986. Do you have any reason to disagree with that?

A. I'm not sure about that docket that you're referring to and the dates. I just don't have knowledge of it.

Q. But -- okay. Well, I can provide -- I can ask the Commission -- I don't have all the specifics before me. I'll ask the Commission to take judicial notice.

But the next time that a general rate proceeding occurred was 20 years later in 2007. Were you working for Duke at that point?

A. I was working for the Company at that point.

Q. And that was actually not a request for an increase filed by Duke, it was an investigation. And the docket was E-7, Sub 828, and rates were actually decreased. After that 20-year period, the rates were decreased about $200 million per year; would you agree with that, subject to check?

A. I would have to take that subject to check. I wasn't in my current role, and at that point I was not involve in rate cases in 2007.

Q. Okay. And since that time, there were three rate cases, one in 2009, another in 2011, another in 2013, and they were all relating primarily to construction of the new Cliffside coal unit; are you familiar with that, those cases?

A. A little bit familiar with those cases. Again, I was in a different role at that time and didn't have a lot of involvement with the cases.

Q. Okay. And there was some controversy. Do you know anything -- when the certificate was issued to -- for Cliffside, there was some controversy about constructing a new coal unit.

But in any event, it was built, and some of the coal units were going to be taken out of service at that point. Is that within your recollection or no?

A. I'm sorry, I don't know that history.

Q. Okay. Well, during all of those rate cases, Duke did not, at those -- in those rate cases seek to include an additional amount related to the coal ash pond closure or the disposal of CCR; isn't that right?

A. I think John Spanos -- witness John Spanos would be better equipped to answer that question.

Q. Okay. Mr. Spanos, you were involved in some of those cases anyway. Did you -- I think you testified last time that you were not asked to look at that cost; am I right?

A. (John J. Spanos) Well, yes. And good morning.

Q. Good morning.

A. In each of those instances, we reviewed what were known and measurable costs, and they were to be included -- anything that we knew and was measurable was included as based on the standards related to regulatory ratemaking purposes. So you are talking about some cases that had multiple factors in place related to why depreciation was either increased or decreased. Not all of them related to one specific component. But all of those -- we did review the depreciation studies and the analysis that was in place, and what was to be most appropriately recovered in the depreciation expense for regulatory ratemaking purposes.

Q. And my recollection is that I asked a question in the last rate case of you, and you indicated that you were not asked to look at the specifics of what might be involved in coal ash closures; is that what you remember, or don't you remember?

A. No, I do remember. The -- I was not asked to include coal ash closure costs in the calculation because it was going to be an ARO. So it would not be part of regulatory ratemaking calculations. So the discussion was not -- that I remember that we had, was not necessarily whether we talked about it, it was whether they were known or whether they were too speculative to include in the calculation for depreciation expense.

Q. Okay. So, in fact, Duke indicated in the last rate case in discovery that it was assumed in the last dismantlement study before CAMA that the salvage value would offset the cost of dismantlement, and that's why it was a zero amount as far as coal ash closure. Does that sound right to you? Do you remember seeing that? It's already an exhibit in evidence if you're not familiar with it.

A. I remember seeing the discussion and the response. The decommissioning component that was included in the study was not related to the coal ash discussions, and I would not consider the fact that, for decommissioning of the other assets within the calculation, that they would have netted to -- the salvage would net to cost of removal, if that's what you're asking.

Q. Could you say that again? I didn't understand your response.

A. Yes. If your question is whether the decommissioning study was supporting a net zero effect of salvage from cost removal for non-coal ash, that's not what the decommissioning studies show.

Q. For non-coal ash?

A. That's right.

Q. Okay.

A. So I'm not sure that that's what you asked me in the last case or what you were referring to in this particular data request, but it sounds as though that was what the question was, and that's why I answered in the fashion that I did.

Q. Sure. And the discovery request and response speak for themselves, so I won't ask you to try to remember what it was. So on this point of quantifying the cost of removal, I'd ask -- well, both of you can turn to it, but I was going to ask Mr. Doss to please turn to AGO Potential Cross Exhibit 29. And just for your purpose of identifying it, that's an EPRI document that's titled "Decommissioning Handbook For Coal-Fired Power Plants."

A. (David L. Doss, Jr.) I have that in front of me.

MS. FORCE: Chair Mitchell, I would ask that this be marked as AGO Doss/Spanos Cross Exhibit 1, please.

CHAIR MITCHELL: All right. Ms. Force, we will mark the document AGO Doss Spanos Rebuttal Cross Examination Exhibit 1.

(AGO Doss/Spanos Rebuttal Cross Examination Exhibit 1 was marked for identification.)

Q. Okay. And you're familiar with EPRI, I assume. And are you familiar with this handbook? Maybe you're not there yet, Mr. Doss.

A. I'm sorry, yeah. I was making sure you were directing that question to me. I'm familiar with EPRI. I have not seen this handbook.

Q. Okay. Just for purposes of the record, the -- on page 2, the report indicates that it was dated in November of 2004, right?

A. I do see that date noted on page 2.

Q. And if you would turn, please, to page 2-5 in the third paragraph under the heading "Solid waste landfills can be a major expense item in decommissioning." I'm just going to quote a sentence from there, and tell me if I got it right, please. Are you there?

A. You're on page 2-5; is that correct?

Q. That's right. And there's a -- the second paragraph under that heading, "Solid waste landfills can be a major expense item in decommissioning"; do you see that?

A. (No verbal response.)

Q. The first sentence in the second paragraph refers not just to solid waste landfills, but other impoundments. It says:

"Closure of surface impoundments and landfills probably will be the most expensive tasks undertaken during a decommissioning process."

Do you see that? Is that fair?

A. I see it.

Q. Okay. I'm going to turn now back to the petition that we were talking about at first, and that is Duke's petition for an accounting order, and talk about that a little bit more.

A. Is this the 2016 petition?

Q. That's right. December 2016. And that's for an accounting order concerning coal ash costs.

Would you agree with me that the request indicated that it was a legal asset retirement obligation that was now recognized by Duke for financial purposes for the legal obligations imposed on Duke when CAMA was enacted in 2014 and the federal CCR rule was promulgated in 2015? I'm not quoting that one. It's more of a general question.

A. That sounds accurate.

Q. Okay. And we talked about this a little bit before. The first part of the request was to defer $2.1 billion, the amount of the total obligation. And it indicates, as you've mentioned, that that was something that was authorized in the 2003 order that we just went through, the Commission order on ARO accounting, right?

A. Correct.

Q. All right. And the other request is to defer the $434.4 million for the amount that was actually spent during the period January 1, 2015, through November 30, 2016, right?

A. Yes.

Q. So comparing that -- the amount actually spent and that request to the 2003 order, can you agree with me that the proposal seeks to change how Duke accounts for its cost of removal so that the costs are not attributed to past years over the full operation of the related plants, and instead -- you know, during the time that that coal ash was produced, and instead now the costs would be recovered from future ratepayers as the expenditures are made through a special deferral mechanism?

A. I'm sorry. That was a really long question. Could you repeat that?

Q. Okay. I can, I think. When you look at the request that is made in this 2016 petition -- and I'm looking -- I'm thinking back to the 2003 order that was referred to -- can you agree that the proposals that are made in 2016 seek a change in how to account for the cost of removal so that the costs of removing the coal ash that was produced over the years of electricity produced at those coal stations will be recovered -- instead of over the life of those assets, will be recovered in the future from ratepayers as expenditures are made for the cost of removal?

A. Well, I wouldn't refer to them as cost removal. As we've laid out in my testimony, that these are costs that are asset retirement obligations. They're not costs of removal, they're asset retirement obligations. So I'm a little bit confused by your question in that regard.

Q. So you're saying that the cost of closing the coal ash ponds and removing that waste is a new asset retirement obligation that has no relation to the operation of those plants over all of those years?

A. It's an asset retirement obligation which is -- the ARO accounting model is a different model than the cost of removal accounting model. So I just wanted to be careful that we're not kind of confusing the two. This is -- these are costs that are accounted for under ARO accounting.

Q. Well, and you wouldn't want to account for them both ways, would you? You don't want to double-count them?

A. No. We certainly don't want to double-count them or double-recover them. We just want to recover them one time.

Q. Okay. Ans so is what you're saying is, in that 2003 order, then, the costs of addressing the closure of coal ash ponds and the disposal of that coal ash waste, you're saying that's not a cost that's associated with dismantling those plants?

A. It's a cost associated with retiring those plants. It's a -- they're legal obligations that fall under the guidance in both FERC and GAAP for asset retirement obligations.

Q. And until the amount was better known under -- because of CAMA and CCR, is it your position that they were nonlegal retirement obligations?

A. No. It's my position, under ARO accounting, these are legal obligations.

Q. So was it a new obligation in 2016 or was it an obligation that Duke had for sometime prior to that?

A. It became obligations upon the enactment of

CAMA and the CCR rules in 2014 and 2015.
Q. And before that, was -- you're saying that there was not an obligation to close these ponds and dispose of the coal ash?
A. I'm not aware of any legal obligations prior to the enactment of CAMA in late 2014.
Q. Okay. Mr. Doss, you've testified that an ARO obligation involves entry for both the obligation and charging the costs to depreciate that obligation over the remaining life of the related tangible asset; do I understand that correctly?
A. Yes, that's correct.
Q. So my question for you is that two point -- that total ARO of $2.1 billion, then, would that be broken down for each of the plants at which the obligation -- legal obligation is determined and spread out over the remaining lives of those plants?
A. Yes, we would have that breakout.
Q. And so, for example, at Marshall, would the usual approach under ARO accounting, but for some sort of a ratemaking order to the contrary, that at Marshall the approach would be to recover the costs over the remaining life of the Marshall coal steam plant?
A. The approach would certainly be to depreciate

those costs over the remaining life of the Marshall steam station.

Q. Okay. But at River Bend where the plant had already been retired for sometime when CAMA was enacted, would that be the sort of costs that might be written off, but for a regulatory order allowing deferral?

A. In the case of River Bend or a plant that had already been retired, the initial entry would be in accordance with GAAP and FERC requirements. Initially would be recorded as a capital cost, but immediately expensed or fully depreciated because that asset is no longer in service.

Q. I see. So in that accounting order where you asked for the petition -- the deferral of those costs as they were spent, there's a reference on page 13, I think, paragraph 22, that the coal ash disposal will be deferred to a regulatory asset account 182.3; do you see that?

A. Yes, I do.

Q. So would you agree with me that that is a FERC account in the Uniform System of Accounts called 182.3?

A. That's correct.

Q. And that is an account that, for regulatory-created assets not included full elsewhere, that they're included there that results from ratemaking actions of regulatory agencies, right?

A. Correct.

Q. So when Duke used that account, is that an account that was used for -- from 2015 -- the beginning of 2015 through the time of the rate case? Is that how that worked while you were waiting for a decision on this accounting order request? You're not -- you're muted.

A. So when we had to -- upon the enactment of CAMA and the CCR rules, we were required to record entries to reflect ARO accounting, which means we recorded the obligation and we recorded the associated asset that was related to that obligation. We began to depreciate that asset, as we do with any asset, and that depreciation, absent any Commission directive, would have been expensed. But since we did have a Commission directive from 2003 to defer the impacts, and the income statement actually deferred that depreciation into a 182.3 account as authorized by the Commission.

So the 2016 order is -- or the 2016 request, pardon me, was a request that, now that we had started to incur the actual cash costs associated with settling these obligations, we're essentially requesting approval from the Commission to transfer those initial costs that have been deferred, which were depreciation expense. You can call them noncash costs if you want to. At Duke we call it the theory reg asset. It's a theory -- a theoretical amount of costs that we have depreciated from those assets that we established.

And now in accordance with the Commission's order from 2003, which had come to us, essentially -- I'm paraphrasing, but come to us later to determine what the recovery method may look like. In 2016, we requested that we be allowed to transfer costs from that previously authorized reg asset into a new reg asset for the spend as we're incurring the spend, so that we didn't pry try to recover from customers any amounts until we had actually spent them. So that's what the 2016 request was accomplishing.

Q. And is it -- I think you've already been through this with Mr. Grantmyre, but if not for that order deferring those costs under ratemaking for consideration in the next rate case, then they would be written off; is that right? In the period?

A. These costs, these -- effectively, the depreciation expense that we've taken on these capitalized assets, if we didn't have some sort of Commission directive to defer those costs, we would have to write those depreciation expenses off.

Q. Okay. And under the -- that account, doesn't it say within the description of 182.3, but for the accounting, based on it being probable, that the cost amount would be included in a different or future period for ratemaking purposes, the amount would be included in that income period? That's what we're talking about when we're talking about writing it off; is that right?

A. That's correct. A regulatory asset allows you to defer that cost and match that cost up over the periods that you're going to be recovering it in rates.

Q. And that sort of recording of the deferral by Duke signals to its investors in financial statements that it anticipates that it's going to recover those costs in the future; is that correct?

A. That would be correct, yes.

Q. All right. When Duke submitted this request for deferral at the end of 2016, it based the request on three arguments; would you agree with me? First, the argument was that the financial impact, if not allowed to defer the costs, would be a large hit to the Company's earnings?

A. Is there a specific -- yeah, is there a specific area of the request you're referring to?

Q. Sure. Look at paragraph 23 on page 14.

A. (Witness peruses document.)

CHAIR MITCHELL: All right. Ms. Force, just for purposes of the record, please remind us which document you're looking at.

MS. FORCE: Sure. It's been admitted as AGO McManeus/Speros Cross Exhibit 1, and it was submitted with AGO Probable Exhibit 43.

CHAIR MITCHELL: All right. Thank you. You may proceed.

MS. FORCE: Do you have it? Okay.

Q. And I need to get to the right page too, Mr. Doss. Do you see that paragraph 23:

"Absent the deferral, the companies may have to write off billions of dollars for accounting purposes which would without question would severely impair the Company's financial stability and ability to attract capital on reasonable terms," right? You're on mute.

A. Sorry. That's paragraph 23.
Q. Pardon me?
A. Yes, I see that in paragraph 23.
Q. And then earlier on pages 12 through 13, for Duke Carolinas in particular, there's a reference to the effect on earnings relating to the 12 months ending 9/30/2016; do you see that?
A. I do see that.
Q. The section on reducing earnings. So the first argument was financial impact. There was also an argument that the cost to the closure is a normal part of the lifecycle of plants, but turns out to be a lot more than was anticipated.
Would you agree with me that that's an argument, and it's due to government action?
A. And could you point me to that paragraph again, please?
Q. Well, if you look on page 2, there was an -- I'm not quoting it.
A. I'm sorry. You're looking -- the question again.
Q. So we're talking about the argument. I'm suggesting that there were some arguments that Duke gave when it requested deferral. And the first one we

talked about was the financial impact if not deferred. The second was that these are high costs. I think they're referred to as extraordinary in some places. And that they're related to government action because of the changes in regulations -- requirements in CAMA; is that -- would you agree?

A. I would agree with that statement. I'm not sure I understand exactly what you're referring to me in this document. But I think the basics of that statement I would agree with.

Q. Okay. And the request also referred to an earlier case in North Carolina involving PSNC. And if you look at page 15, footnote 8, there's a specific reference to it. It said that, in that case, the utility was allowed to defer and recover environmental costs for manufactured gas plants. Do you see where I am on page 8?

A. I see that reference.

Q. Okay. So these were three reasons that Duke gave.

Would you disagree with me that those are fairness arguments? That the costs are extraordinary and the impact on earnings would be great, and given to justify the request of the Company to defer these costs

for recovery?
A. I'm sorry, did you refer to them as fairness arguments?
Q. Yes.
A. I'm not familiar with that term. I don't know if that's a legal term, but I think that there's clearly arguments in here.
Q. And those would be reasons why the Company's asking for special accounting treatment and deferral treatment?
A. Because of the new regulations, the large amount of the costs which would, as you pointed, severely impair the Company's financial stability.
Q. And would you disagree with me that those are arguments why it's fair for the Commission to allow these costs to be deferred?
A. No, I don't think I could disagree with that. I think those are arguments that are trying to establish fairness.
Q. And to defer those so that the recovery is based on deferral of the costs as they're spent?
A. That's correct, yes.
Q. All right. Okay. Now, the -- to clarify too, the comments in the accounting proceeding that

were filed by various parties were received by the Commission, and that accounting request was consolidated into the last rate case for decision. Does that -- do you agree with that? Do you remember that?

A. That sounds -- that sounds right.

Q. So the -- they were addressed in the rate case order in 2018, right?

A. That's correct.

Q. So, Mr. Spanos, I do have a few questions for you.

In your testimony on page 28, your rebuttal testimony, you refer to resistance that you've noticed to -- including environmental costs as closure costs, or dismantling costs; am I right about that?

A. (John Spanos) On page 28, I'm referring to resistance in many of the decommissioning costs. So that is what's being discussed in that section on page 28.

Q. Let me get there. And that's the section where you talk about ash pond costs; am I right? If you turn back to page 27, it's under that heading?

A. Under page 27, it is under the ash pond cost reading, but the reference that we are talking about on page 28 is discussing the history of decommissioning and all of the components and the resistance that utilities have received and I have received in conducting studies as to what are considered to be costs that should be recovered through depreciation expense for ratemaking purposes.

Q. But you're not saying, are you, that Duke Carolinas has sought to include specific costs for coal ash disposal and closure cost of removal relating to coal ash ponds and disposal of the CCR in -- and have -- and met with resistance in North Carolina in earlier cases prior to CAMA, are you?

A. No, that's not the discussion that I'm having here on page 28 of my rebuttal testimony. I'm discussing more the history of the resistance that we have in recovering all of the costs that are incurred or expected to be incurred due to decommissioning, for one, cost removal in certain aspects for others. So that's the discussion I'm having. It's not specific to coal ash ponds.

Q. And you do mention a study in the Duke Energy Progress case in -- rate case in 2012 that did include an amount for coal ash closure, right? Do you remember that?

A. Yes, I do. And in that particular case, there were some -- well, a study that was included in the -- depreciation study related to decommissioning that included some costs for coal ash closure. It was very clear that that was a very small component of what has been anticipated or expected and now are classified as an ARO.

Q. And so -- and there wasn't any -- nobody contested the inclusion of those costs in that DEP case, right? It's mentioned, but there's no real -- those costs were included, but there's no real discussion of anybody arguing against those costs being included, is there, in that proceeding?

A. I don't know that answer. I was not involved in that particular case to know whether there was any contention related to those costs. I know that those costs were very small in comparison to what we know today or what is expected today and are now recorded as AROs.

Q. Okay. Thank you.

MS. FORCE: I don't have any other questions.

CHAIR MITCHELL: All right. Any additional cross examination for the panel?

(No response.)

CHAIR MITCHELL: All right. Redirect for the panel?

MR. JEFFRIES: Thank you, Madam Chair, this is Jim Jeffries. I have a couple of redirect questions for Mr. Spanos.

REDIRECT EXAMINATION BY MR. JEFFRIES:

Q. Mr. Spanos, do you recall some conversations with Mr. Dodge about account 366 and how net salvage was calculated?

A. (John J. Spanos) Yes, I do.

Q. Can you kind of refresh everybody's recollection about what the disagreement was there between the Public Staff and your position?

A. Yes. Public Staff had recommended a net salvage percent that was less than what's currently being utilized and based it on the concept of expense versus a ratio of expense or incurred cost removal to accrued cost removal and the factors, the differentials between those. And that is, as a practice, not something that's considered to be an appropriate method for determining a net salvage percent.

Whereas my methodology, which was consistent with all of the other accounts, was to do a combination of statistical analysis, informed judgment, which includes not only the current estimate but also Company practices and understanding of the statistical data to make sure that the most reflective future net salvage component for this specific account would be consistent with the net salvage percent that's projected.

So that was the discussion that we had, and my understanding to what was presented in front of me from Ms. McCullar's testimony and her work papers were to view what the comparison was of incurred cost -- current incurred cost to accrued cost. And that was -- that's a step that's not known to be appropriate for developing future net salvage percents.

Q. So let me break it down a little more simply. When you're trying to figure out net salvage, you're engaged in a forward-looking cost estimation exercise; is that -- would you agree with that?

A. Yes. That's a component, a major component, because we already know what has happened in the past, so the net salvage percent is to be applied on a go-forward basis. So that's the overall purpose of determining your net salvage percent. Now, you can look at what's happened in the past as a guideline, but that's just one of the pieces that allows you to have known information as part of your decision-making process.

Q. And would it be fair to characterize Ms. McCullar's approach as being a backward-looking approach?

A. That is the process that we see. Now, it was a little peculiar to me that all of the other methodologies and practices of the other accounts were fine and that that particular one account would have a different approach that would reflect her methodology of looking at it as a backward approach or comparing past incurred costs to what the accrued level would produce.

Q. Mr. Spanos, do you recall that Mr. Dodge showed you a decision of the Kansas Corporation Commission rate case decision involving Atmos Energy?

A. Yes, I do.

Q. Okay. And that was -- and that was introduced into evidence as Public Staff Spanos Rebuttal Exhibit -- or Rebuttal Cross Exhibit Number 1, and then I think it was Public Staff Exhibit 36 on their proposed exhibits. Do you have that handy?

A. (Witness peruses document.)

Q. Mr. Spanos, did you hear me?

A. Yes, I'm sorry, I was going to it. I apologize.

Q. Oh, no, that's okay. So I'm going to turn to it at the same time.

A. Okay.

Q. And just let me know when you're there.

A. I do have the document in front of me.

Q. And specifically I would refer you to paragraph 54 in that exhibit. Just let me know when you're there.

A. I am there, yes.

Q. So could you read the first sentence of paragraph 54 out of that order.

A. "After examining the evidence on the issue of net salvage, the Commission is not convinced that it must adopt a particular methodology as the only right approach in this docket."

Would you like me to continue?

Q. Yeah, continue to the second sentence too, please.

A. "However, the Commission rejects CURB's methodology because it relies solely on the recent historical net salvage experience."

Q. All right. So they -- does that appear to you that the Kansas Corporation Commission rejected a methodology that was based solely on historical experience?

A. Yes, that is -- that was the basis of what CURB put together and their calculations in that particular study for net salvage, and they rejected that methodology.

Q. Okay. Could you read the next two sentences, please?

A. "Although their methods of determining net salvage, Atmos staff and CURB agree that the purpose of a net salvage analysis is to estimate the future level of net salvage that Atmos will incur as part of its depreciation expense. Both staff and Atmos agree that a net salvage analysis should estimate appropriate levels of future net salvage, not solely rely strictly on historical expense levels."

Q. So that sounds consistent with the conversation we just had about the purpose of calculating that net salvage; does it not?

A. That is correct. That is exactly what we want to avoid doing in determining a net salvage percent in a depreciation study, if you want to make sure that you are estimating what's going to happen in the future. And it's based on not only past data but more importantly what we know to happen going forward.

Q. And so finally, would you read the last two sentences of that paragraph?

A. "When deciding between Atmos and staff's net salvage analysis, the Commission finds staff's approach will best balance the interest of Atmos' current versus future ratepayers. Again, this finding is not based on adopting any particular methodology in this docket, but that staff's approach strikes the best balance between current and future ratepayers."

Q. Okay. So what the Commission said is that we've got two forward-looking analysis here, and we -- without adopting a specific methodology, we're going to choose staff's because we think it's the most balanced; but in doing so, they specifically rejected the historical approach, correct; is that your interpretation?

A. That's correct. No, that's correct. They wanted to make sure that they were clear to reject an analysis that's based on historical incurred costs only.

Q. All right. Thank you. Do you recall a conversation you had with Ms. Holt yesterday where she -- you and her were having a discussion about what I would characterize as the Public Staff's approach to early plant retirements, and she took you through a number of orders or petitions where folks had either agreed or proposed to use this amortization approach when faced with the early retirement of physical facilities; do you recall that conversation?

A. I do.

Q. And that's not the approach you propose with respect to the early plant retirements in this case, correct?

A. No. I -- I've consistently recommended to utility companies that the -- you need to follow the appropriate practices that is within the industry, and that is to recover your investment over the lifecycle of the assets. And those probable retirement dates are what we know at the point in time of conducting the study, and that's what is the most appropriate manner in which depreciation expense should be recovered consistent with general principles and practices within the industry.

Q. And put really simply, isn't it -- from your perspective, isn't it better to use current depreciation rates rather than outdated depreciation rates when calculating depreciable lives?

A. Yes. Whenever you can incorporate not only the most up-to-date data but also the most up-to-date information and knowledge to be expected, that would be the most appropriate thing to do versus going back and just maintaining expectations of when it happened years ago. So it's very beneficial. And the purpose of conducting depreciation studies is to ensure that you're getting the most appropriate information to help your informed judgment, which is the standard that all authoritative text instruct is to follow the guidelines, not only the Uniform System of Accounts, but also the guidelines that are in place for conducting an appropriate depreciation study, which includes informed judgment, which would be information you know as currently as possible.

Q. Thank you.

MR. JEFFRIES: That's all the questions I have for Mr. Spanos, Madam Chair.

MR. MARZO: Madam Chair, I do have some redirect for Mr. Doss.

CHAIR MITCHELL: All right. Proceed, Mr. Marzo.

MR. MARZO: Thank you, Chair Mitchell.

REDIRECT EXAMINATION BY MR. MARZO:

Q. Mr. Doss, I want to start with, I believe it's AGO 43, which is the Company's 2016 application that Ms. Force had asked you some questions about. Do you recall that document?

A. (David L. Doss, Jr.) Yes, I do.

Q. Now, you were asked about the recovery of coal ash costs in the 2016 deferral application.

Now, for clarity, at the time that application was made, coal ash costs were an asset retirement obligation; is that correct?

A. That is correct.

Q. And was the request -- and the request in that particular deferral application wasn't to treat those costs as cost of removal; is that right?

A. That is right.

Q. Now, is the regulatory deferral part of the regulatory model for ARO recovery for regulated utilities?

A. Yes.

Q. Okay. In fact, if I look at the 2016 application, am I correct that in addition to the application itself, it also has an attachment? And I believe that attachment is the Savoy letter; is that --

do you have that --

A. That is correct.

Q. -- 43?

A. Yes, I do.

Q. And I'm going to read something on page 6 of AGO 43 I'm going to ask you some questions about. First off, on page 6 under assets associated with the liability recorded related to AROs, there is the paragraph that states:

"At the time the ARO liability is recorded, a corresponding and equivalent ARO asset is recorded on the books as part of the cost of the associated coal plant in the property plant and equipment accounts. Or if associated with the retired coal plant regulatory asset, the ARO PP balance is depreciated over the remaining estimated plant lives, and such depreciation expense is deferred to regulatory asset account."

Does that summarize the treatment that the Company utilizes for its ARO recovery for coal ash costs?

A. Yes, that's a good summary.

Q. Okay. Now, if I go down to page 7, at the top of page 7, there's a discussion of why the deferral takes place. And the first paragraph, and I'm going to read this and ask you to explain it to me, it says:

"The FASB recognizes -- recognized that differences may exist between the requirements of ACS 410.20 and the treatment of ARO costs regulatory purposes, and accordingly, provided that a regulatory entity subject to ASC 980, regulated operations, formerly SFAS 71 accounting for certain types of regulations, could recognize a regulatory asset or liability for any difference between the two approaches if the facts and circumstances meet the requirements of ACS 980 for such recognition."

Now, that sounds to me that that relates to the matching of when costs are incurred and when they're recovered for regulatory purposes; am I understanding that correctly?

A. You are understanding that correctly; that's right.

Q. Okay. And does the Company's actions in this case, as it pertains to this ARO, does it meet the requirements of ACS 980 under FASB?

A. Yes, it does meet the requirements under ASC 980 for the deferral of these costs into a regulatory asset.

Q. Now, the Commission's deferral order, is that just the final component of the model that we essentially called the ARO recovery model? So they all work collectively together as one system for cost recovery, making sure that the costs that are incurred are matched with the time in which they're recovered?

A. Yes, I would agree. I mean, it's all just sort of a continuation of the process that was established in the 2003 order from the Commission in which we are directed to defer the impacts until they could be considered in a future proceeding. And this 2016 order is just a continuation of the process that the Commission established for addressing these costs.

Q. And you mentioned that this actual application for 2016 is not the last time the Commission has spoken on ARO recovery, correct?

A. That is correct.

Q. Okay. Would the Commission's order in the last rate case be the most recent time that they've spoken to ARO recovery for Duke Energy Carolinas?

A. Yes, it would.

Q. Do you have that order in front of you? And it's DEC Cross Exhibit Number 1 if you need to find it in your materials.

A. I do have that order.

Q. Now, would you turn to page 283 of that order. And just let me know when you get there.

A. I'm sorry, I'm there.

Q. Okay. Would you mind reading from the last paragraph on page 283, it carries over slightly to the following page, which is 284?

A. Sure. Starting with that paragraph?

Q. Yes.

A. "First, the Commission disagrees that the Company chose ARO accounting. The Commission has already so held in the 2018 Duke Energy Progress case that once it became clear that the new laws and regulations governing coal ash would require closure of the Company's existing coal ash basins, GAAP required that an ARO be established, and the Company had no choice in the matter."

Q. If you could keep going just to the end.

A. Sure. The next sentence reads that:

"Further, as Company witness Doss testified, in addition to GAAP requirements, the Company was also required to and did adhere to and apply the accounting guidance under the FERC code of federal regulations as well as orders of this Commission. The Company's ARO accounting complies with the authoritative statements of GAAP, FERC, and this Commission."

Q. Thank you, Mr. Doss. And as it pertains to the costs being sought for recovery in this case, are those statements still correct in regards to our compliance with GAAP, FERC, and the Commission's orders?

A. Yes, it's still consistent, still the same.

Q. Okay. And you were asked a number of questions, I think, even earlier Mr. Spanos may have gotten some questions about, well, what if we just don't follow the Uniform System of Accounts? Can the Commission deviate from the Uniform System of Accounts?

Mr. Doss, as the head accountant at Duke Energy Carolinas and as someone who I know understands entirely the purpose behind the Uniform System of Accounts, what are some of the dangers with considering a deviation from the Uniform System of Accounts as being suggested by some parties?

A. Well, it would give me great pause. You know, based on my experience in doing accounting and being a CPA for 35-plus years, you know, Generally Accepted Accounting Principles and the FERC system of account are established so that companies have guidelines to follow, and so that investors and other users of the financial statements know that the -- that the books and records are prepared on a consistent basis and that there's comparability across companies. So it would give me great pause to think that we might be considering anything that would deviate from the either GAAP or from the FERC Uniform System of Accounts.

I think that, you know, even just as implied by the FERC's name for it as a uniform system of accounts, there's great value to the financial community and I think to others who use the financial statements to have that assurance that utilities are on a uniform system of accounts and there's comparability, consistency across utilities.

And I think it's extremely important really in the case of Duke Energy Carolinas, and Duke Energy Progress for that matter, where we are operating in two states and we also have FERC customers. So it would give me great pause to think that we might be thinking about doing something different, establishing some different accounting model within the state of North Carolina that would not only be -- not only deviate from every other utility in the industry, but also deviate from what we might be doing in our other jurisdictions, as I will call them in South Carolina and the FERC jurisdiction with Duke Energy Carolinas.

Q. And does that create a situation where you potentially could be looking at two sets of books, which I know is a scary thing for someone in your position, correct?

A. It is a scary thing to think about, and I can't say that I fully considered all the potential impacts that might come about from that. But it could very well result in having a different set of books, certainly which would create a heavy administrative burden on the Company. And I think, as I said before, for users of the financial statements, potentially create a lot of confusion out there in trying to compare Duke Energy Carolinas' North Carolina jurisdiction to the others, as well as trying to compare Duke Energy Carolinas overall to other utilities in the industry.

Not to mention that, you know, when we have our books audited, whether there's an audit of our GAAP books to -- the auditors will opine that the books are materially correct according to GAAP principles. There's another audit that's done on our FERC books, and like I said, I haven't considered all the implications, but we'd potentially have to have a North Carolina set of books that we might have to do something similar for.

So again, not having given it full consideration of all the potential implications, it's just something that I would put out there as something that I think that I would hope that we would all consider very carefully.

Q. And you got some questions from Mr. Grantmyre earlier, and I think he was referring to your Exhibit 1 which included subtopic 15-2 related to the normal operations and ARO treatment; do you recall those?

A. I do recall that, yes.

Q. Now, just to be clear, the costs that are being sought for recovery in this case, they're part of what is normal operations, correct?

A. That's correct.

Q. Okay. I think Mr. Grantmyre may use the term "improper operations," but that's not anywhere within subtopic 15-2, that terminology; is that correct?

A. That's correct. Improper operations would not fall under the guidance for ARO accounting.

Q. And I think you were asked some questions about Belews Creek, the extraction well recovery.

Just for the record, is it your understanding that the cost for the extraction wells was recovered in the last rate case?

A. I believe that to be the case.

Q. Okay. So the Commission did allow recovery -- that the amount of recovery that was included in that case could be recovered in that case?

A. I believe that's correct.

Q. Okay. Now, you and Mr. Spanos were asked some questions about AGO, I believe it's Exhibit 29. And this is the decommissioning handbook for coal-fired power plants. I think Ms. Force asked you some questions regarding this; is that correct?

A. That's correct.

Q. Okay. And I think she cited you to one page, and I'm not -- I didn't write that page down, but I did want to refer you to another page of the document. If you would turn to page, I think it's page IV in Roman numerals.

A. (Witness peruses document.)

Q. The heading at the top is "Results."

A. Yes, I'm there.

Q. Okay. Now, do you see where essentially it discusses three different ways that they're looking at decommissioning projects and basic options; do you see that?

And one of those options is to maintain the site as present condition with minimal cleanup, meet environmental compliance, and ensure safety. The other one is perform minimal dismantling and demolition while maintaining the site to meet environment compliance requirements and ensure safety. The other one is dismantlement to a degree required to meet specific needs of plan and reuse to the site. And the final one is full decommissioning, correct?

A. Yes. Those are the options that are presented here.

Q. I know you're not familiar with the report, but are you familiar with or do you know whether or not any of the sites here are sites that would provide information in terms of what Duke might do for Duke Energy Carolinas' facilities? Do you know if their sites are analogous is the way I should have asked that question.

A. I'm sorry, could you repeat that question?

Q. Yeah. I was asking, do you know if any of these sites are really analogous to Duke Energy Carolinas' sites?

A. I don't really know. I mean, this is a range of options, and I assume that there could be some applicability to Duke Energy sites. But not being familiar with this document, and -- it would be hard for me to say with certainty.

Q. Yeah. And that's fair enough. And I know this is the first time you're seeing this document, Mr. Doss. I think that's fair. And, of course, Ms. Bednarcik, Mr. Wells, and Ms. Williams could speak more about it if there are more questions about it.

I did want to point you -- well, let me ask you this question. Clearly, one of the things to consider is exactly -- one of the things to consider within this document is whether or not -- what options a utility is considering in terms of reuse of a site, correct?

A. Correct.

Q. Something you consider? Okay.

A. Yes.

Q. Would you turn with me to page A6 of this document, which refers to one of the test case of the three test cases that are included in this document.

A. (Witness peruses document.)

Q. And this refers to a Georgia power plant which is Georgia power plant Arkwright, which was decommissioned sometime around 2003 or '04, I believe 2002, 2003.

Do you see that paragraph at the middle of the page that starts with "after the plant is retired"?

A. I do see that.

Q. Okay. Now, if you go one sentence down into that paragraph, tell me if I'm reading this correctly. It says:

"In agreement with the state regulators, pond number 1 was closed with a cap under 1980 regulations which were in effect when the pond was retired."

Does that suggest that the state regulators had significant input into the process of closure?

A. Yes, it does.

Q. Okay. Thank you, Mr. Doss, on that. Now, I just want to refer back to one more line of questions. Now, if you look at your testimony or you look at the order from the last rate case, and you look at the paragraph right below the paragraph I had you read that's on page 284.

A. (Witness peruses document.)

Q. Could you read that paragraph for me? It starts with "witness Doss."

A. Yes.

"Witness Doss provided an extended explanation of the GAAP, FERC, and deferral directives that govern the manner in which Company established the ARO and has accounted for coal ash basin closure costs in the ARO. The Commission credits his explanation and testimony which are uncontradicted."

Q. Now, there's been some discussion in the current case, and maybe even an illusion that some individuals may have been confused as to how ARO accounting has occurred.

Did you review the Commission's determination in the last order?

A. Yes, I did.

Q. Now, does that discussion cover several pages, including sections specifically designated GAAP, FERC, Commission deferral order, and summary of accounting rules deferral, the Savoy letter, and the procedure for establishing a deferral?

A. Yes, sir.

Q. Are those all sections in the order? Okay.

A. Yes.

Q. Now, I think we said this earlier, but DEC has not deviated from the recovery process that's outlined in that order, correct?

A. No. DEC's accounting practices throughout this period, beginning with 2015, have been consistent.

Q. Do you believe there was any confusion in the last case as to how the Company's ARO accounting would work?

A. No, I don't see how there could be confusion. I believe, even in this order, the Commission stated that, through the Savoy letter, we had, you know, explained exactly how the accounting was going to work. You know, going back to the time of the Savoy letter that was 2015, the deferral request from 2016, the last two rate cases, the DEC and DEP rate cases, I think we've been very consistent, very transparent, I think, in how we've been doing the accounting.

And we've been consistent throughout the years. We've responded, as far as I know, to every data request, any request for additional information related to how we were doing this accounting. And now almost five years later in 2020, after we established a framework for it in the ARO accounting, and how we explained it in the Savoy letter in 2015, we're still doing it the same way.

And I think there's been ample opportunity for anyone -- any interested parties to ask questions. As I said, we've done our best to be transparent and answer any questions that have come our way. So I don't know why there would be any questions here since I think we've had five years to kind of get a good understanding of the accounting that we're applying.

Q. Thank you, Mr. Doss. And one last set of questions. You were asked by Mr. Grantmyre, I believe, primarily, and maybe a little bit by Ms. Force, some questions related to used and useful.

And I'm going to ask you, under GAAP and FERC accounting guidance, are the assets created when the Company recognizes the ARO considered part of the property plan and equipment for the asset?

A. Yes, they are.

Q. And is that consistent with these capitalized assets being treated as used and useful property?

A. Yes.

Q. And are there ARO-capitalized assets intended for -- are these assets intended for environmental compliance?

A. Yes, they are.

Q. Are they intended for the retirement of the ash impoundments and the final storage location for

residuals from generation of electricity?
A. Yes. As I stated in my testimony, that is true.
Q. Okay. Thank you, Mr. Doss.
MR. MARZO: Chair Mitchell, I have no further redirect.
CHAIR MITCHELL: All right. Questions -- at this point in time, actually, we are going to take a break. Let's see, it's 10:55, we'll go off the record now. We will be in recess until 10 after 11:00.
(At this time, a recess was taken from 10:54 a.m. to 11:11 a.m.)
CHAIR MITCHELL: All right. Let's go back on the record, please. We will begin with questions by the Commissioners.
Commissioner Brown-Bland?
COMMISSIONER BROWN-BLAND: No questions.
CHAIR MITCHELL: All right. Commissioner Gray? Commissioner Gray, any questions from you?
COMMISSIONER GRAY: Sorry. No questions, thank you.
CHAIR MITCHELL: Okay. Let's see,

Commissioner Clodfelter?

COMMISSIONER CLODFELTER: Yes, thank you.

EXAMINATION BY COMMISSIONER CLODFELTER:

Q. Mr. Doss, I've got just a couple of questions for you. Can you hear me okay?

A. (David L. Doss, Jr.) Yes, I can.

Q. Okay. My questions are prompted by a document, but I'm not going to ask you questions about the document. It's just the document is what prompts the question. And it's really a question about the transition to ARO accounting, when that occurred.

In the last DEC case, we had as an exhibit to testimony of David Fountain, it was Attorney General's Cross Examination Exhibit 6. It was a presentation by Jason Allen and David Fountain to the senior management committee in January 2014. That was before the Dan River spill and before CAMA was enacted. And they were discussing in the document the situation regarding the coal ash impoundments at the various Duke plants.

And one of the topics that was discussed in the document, in the presentation, was the potential for using the then accumulated cost of removal reserve attributable to the steam production plant, the possibility of using some of that to offset what was expected to be incurred with respect to closure or remediation of the coal ash impoundments. And they showed in the document that there were certain balances that had accumulated for each of the affiliated companies.

So my question really to you is not about the document. But at that point in time, clearly, no decision had been made by the Company about whether to deploy those accumulated costs of reserve amounts that had been collected through rates to deploy that to offset any of the expected coal ash expenditures.

So my question to you really is that, when the point in time came when the ARO accounting was established, was any portion -- was any portion of that accumulated steam production plant cost of reserve taken into consideration in making the cumulative adjustment?

A. Commissioner Clodfelter, for Duke Energy Carolinas, it was not. As I think you're aware for the Duke Energy Progress case, there was a little bit of -- a very small amount that had collected. But for Duke Energy Carolinas, there was nothing specifically earmarked that we could transfer.

Q. So when the cumulative adjustment was made -- when the ARO accounts were established and the cumulative adjust was made, no part of that was included in the adjustment. And was that because the Company considered that that had been collected in rates on account of decommissioning costs other than coal ash costs? Is that why no part of that was taken into account in the cumulative adjustment?

A. That's right. And as witness Spanos can also opine on this, but at that time, there were no amounts that had been specifically collected from customers related to the retirement of the these coal ash ponds. So there was no amount for us to transfer in the case of Duke Energy Carolinas.

Q. That's what I thought was the case, but I needed to ask you, because you actually did the making of the cumulative adjustment when the ARO was established. I needed to know that I understood the sequence of events correctly.

In that presentation, Mr. Fountain and Mr. Allen said that there were different points of view as to whether or not that accumulated cost of removal of reserve could be tapped for purposes of coal ash closure, pond closure, or remediation. And Mr. Allen and Mr. Fountain say there were two different points of view. One is that we can do it, the Company can do it; another point of view is no, we need to notify the regulators.

Do you know if that difference of opinion was ever resolved in the Company before CAMA was enacted?

A. Well, I would tell you -- and this exhibit was put before me as well, Commissioner Clodfelter, in the last --

Q. I had forgotten that. Thank you for reminding me, I had forgotten that.

A. Yeah. And I was not involved in the preparation of this or in my role at the time, but I will tell you these are my thoughts when I look at this. Those notes that you referenced, those were actually some notes that were at the bottom of the slide and --

Q. Okay.

A. -- as anybody who knows who has ever prepared some presentations in PowerPoint, you might have some notes that you put into it as you're developing your slides. And, in fact, they might be left over from previous versions or draft versions that you're working on. So the points of view, those different points of view that you reference, I notice that's in the notes section.

What I would say -- and I'm speculating here, because as I said, I wasn't involved, but I would focus on the actual slide, itself. And on the actual slide, itself, it doesn't even go into those points of view. It concludes that regulatory approval likely -- would likely be required to do any sort of a transfer between these cost of removal reserves.

Q. And that would be true -- regulatory approval would have been required because the cost of removal reserve was accumulated in consequence of approved depreciation studies that did not include any costs associated with the coal ash ponds. That's why regulatory approval would have been required; is that correct?

A. Yeah, that's right. And I would say that, as the accountant, that would give me -- I would be very concerned about -- and I don't know if accounting was, you know, consulted for this presentation or not, but I would say that, you know, that would give me some great concern. We have very scientific studies for these cost of removal reserves, and they're done by function.

As I look at this slide, it seems to indicate that they were thinking maybe some could be potentially reallocated. And granted, we know at this time that this was sort of a developing story, if I could use that sort of a term, in that there was a lot of difference -- you know, the costs were constantly changing, is my understanding. And the views on using cost for removal, I think, were people were trying to come to grips with what could potentially be done with cost of removal reserves.

Sitting here today, you know, looking back on it, I -- and where we are with our cost removal reserves now, they're so scientifically calculated. And John Spanos can touch on this too as well that, you know, to -- to try to raid one of the other functions' reserves, I think we'd need to think about that very carefully. Because those reserves are, you know, done under calculations to make sure that they're adequate. It gives me concern that maybe at this time there was some thought that there was some excess reserves or something like that available to use, but I don't believe that we have, especially in the steam reserve right now.

Q. But you've answered my principal question, which is --

A. Okay.

Q. -- the fact a reallocation, or reassignment, or redeployment did not occur, in fact?

A. It did not occur.

Q. Because if it had occurred, you would have had to show that in your cumulative adjustment?

A. That's right. That's right.

Q. And you did not do that?

A. We did not. And to do any sort of transfer like that I think likely would have required us to come to the Commission.

Q. Thank you, Mr. Doss. I just needed to be sure I understood the history accurately and that the numbers flowed the way I thought they flowed. Thank you.

A. Absolutely.

COMMISSIONER CLODFELTER: That's all. I have nothing further.

CHAIR MITCHELL: All right. Commissioner Duffley?

COMMISSIONER DUFFLEY: I just have one question for Mr. Doss.

EXAMINATION BY COMMISSIONER DUFFLEY:

Q. I just wanted to clarify your testimony. You were talking about concerns that you had about a deviation of the current accounting practices that you have -- that the Company has set up, and that you would have to carry two sets of books. But you weren't specific in what kind of potential changes that the Commission was considering.

Are you speaking -- well, I'll just ask you. What exactly -- what exact practice are you speaking to? Or potential change?

A. (David L. Doss, Jr.) Potential change? I think that there was an exhibit presented earlier in the case. I don't recall exactly by whom, but -- and it was around the rules where the Commission has adopted the FERC Uniform System of Accounts as the North Carolina system of accounts, essentially. I think in that rule it also states that the Commission, at its discretion, could make a deviation from the FERC Uniform System of Accounts.

And it seemed to me that maybe in some of the earlier testimony I heard -- and maybe I misinterpreted, but I thought I heard some hints that we might consider doing a deviation from the FERC Uniform System of Accounts. So I just wanted to make sure that I expressed my concern if there were any thoughts that we might be entertaining something like that.

Q. And what would that deviation be? I mean, what were you assuming that deviation would be?

A. Well, for instance -- and I'm thinking in terms of the recent Dominion case, and there was some talk about using cost of removal -- sort of commingling cost of removal and ARO accounting. And they're two separate and distinct things. I think that upon reconsideration, that was sort of straightened out in the Dominion case, but that -- that's just one example.

Q. Okay. Thank you. No further questions.

COMMISSIONER HUGHES: No questions for me.

CHAIR MITCHELL: Okay. Thank you, Commissioner Hughes.

Commissioner McKissick?

COMMISSIONER McKISSICK: No questions at this time.

CHAIR MITCHELL: All right. Thank you, Commissioner McKissick.

EXAMINATION BY CHAIR MITCHELL:

Q. Mr. Doss, I do have one question for you, and I hope you can just tell me this off the top of your head. Do you recall the point in time in which DEC first recognized or initially recognized CCR-related AROs?

A. Yes, that was in the third quarter financial statements of 2014.

Q. Okay. Okay. Thank you, sir.

CHAIR MITCHELL: All right. We will entertain questions on Commissioners' questions, starting with intervenors.

MR. GRANTMYRE: This is Bill Grantmyre, Public Staff. I have one question -- one or two follow-up questions for Mr. Doss on Commissioner Duffley's question.

EXAMINATION BY MR. GRANTMYRE:

Q. She was -- you were asked about deviations from current accounting practices, but on your audited financial statements, don't the auditors make notes or have notes inserted on the audited financial statements explaining any deviations from GAAP accounting?

A. (David L. Doss, Jr.) Well, first of all, I can't think of any deviations.

Q. If the Commission -- if the Commission -- I'm sorry, go ahead and finish.

A. No. I -- I'm trying to make sure I give you a full answer on that. And I'm thinking on our GAAP statements, I'm not aware of any notes that the auditors make or that we made as far as deviations from Generally Accepted Accounting Principles.

Q. Well, if, in fact, the Commission ordered that the ARO deferred cost be recovered over 25 years with no return, would that be a deviation from GAAP accounting principles?

A. I don't know that that would be a deviation from GAAP accounting principles, I think that might be a deviation from what the Company would consider to be fair principles. But from a GAAP perspective, you know, we have had in the past regulatory assets that are -- where a return may not be granted in some cases. And, you know, we would -- to the extent that that is a material issue, that could be noted in the financial statements.

Q. Thank you. I have nothing further.

CHAIR MITCHELL: All right. Any other questions on Commissioners' questions from intervening parties?

(No response.)

CHAIR MITCHELL: All right. Duke?

MR. MARZO: Just a couple,

Chair Mitchell.

EXAMINATION BY MR. MARZO:

Q. Just real quickly, Mr. Doss, I wanted to make sure I completely understand for clarity of the record.

In regards to the steam reserve, as you stated earlier, it is -- what is -- could you elaborate further on the concern there with the use of dollars that are not already allocated for the steam reserve?

A. (David L. Doss, Jr.) Certainly. I think our concern is that there may be some -- some thought that there is excess reserve there to use. And so our analysis shows that there is, in fact -- there's not -- when it comes to the steam production reserve, there is not an excess reserve. In fact, we think that the reserve is adequate, but it's not at the level that our current depreciation study shows that it needs to be. It shows that it still needs to be built up over time.

We've got a late-filed exhibit that shows -- and this was in response to Commissioner Clodfelter's request that we elaborate on the Speros exhibit around cost of removal, that will show that that reserve, for instance, is around $130 million currently. Based on our depreciation study, it shows that we need to build that reserve up to some $400 million in the coming years.

So while we feel like it's adequate now, it needs to be built up. I just wanted to make sure that there wasn't some thought that we have excess reserves that could be used to help fund these coal ash remediation costs.

Q. Thank you, Mr. Doss. In regards to the question that Commissioners asked you regarding the concern about not applying FASB and FERC requirements, that does not -- when you said you had a concern related to that, am I correct that that -- that that does not evidence a concern that the Commission can make alternative ratemaking decisions, but those decisions can be made or still be consistent with FERC and with FASB regulations; is that a fair way of putting it?

A. Absolutely. I think that there are just a number of options and alternatives in the accounting and in the ratemaking that are consistent with FERC requirements or the FERC Uniform System of Accounts. So I would hope that we could come to, you know, some sort of a resolution that would allow us to stay within the confines of FERC and the confines of GAAP without doing some sort of a deviation that -- and I'm not an

attorney, but it appears like in the rules that the Commission potentially could have the authority to deviate from FERC rules.
So that was all I was trying to -- the point that I was just trying to get across, is that I think that we should all -- I would hope that we would proceed cautiously with any such ideas in that vein.
Q. Thank you, Mr. Doss. Are you familiar with the Company's late-filed exhibit I believe in response to Commissioner Duffley?
A. And if you could remind --
Q. It's Exhibit 1. It just has various cost recovery scenarios on it.
MR. GRANTMYRE: I would object. I don't remember any questions on Commissioners about Cross Exhibit 1 or late-filed Exhibit 1.
CHAIR MITCHELL: Well, let's see where he's going with these questions. Mr. Marzo.
Q. Mr. Doss -- and I'm going to try to stay exactly to the Commissioner's question in regards to FASB and FERC requirements.
Are you familiar with that exhibit, first?
A. I might need to put my eyes on it to refresh myself with that one.

Q. Okay. It is the exhibit that has various ash basin closure cost recovery scenarios and impacts on it. And it was filed on -- I don't have the exact file date.

CHAIR MITCHELL: September 2nd.

MR. MARZO: September 2nd. Thank you, Chair Mitchell.

Q. I was going to ask you one brief question related to that.

A. Yes. Let me get that one here. Okay. I'm sorry, I do have that one in front of me.

Q. Okay. So when you expressed the regulatory concerns that we would have from deviations from FASB and FERC and from regulatory practices of the Commission, you were not suggesting that the Commission can't consider various scenarios for ratemaking, only that those scenarios should be consistent with ratemaking, correct?

A. Oh, absolutely, yes. I understand that the Commission has authority to consider all types of scenarios. Again, my concern being expressed there was that we just stay within the confines of FERC and what's, you know, considered to be in compliance with the Uniform System of Accounts.

Q. Thank you, Mr. Doss.

MR. MARZO: Chair Mitchell, I have nothing further.

CHAIR MITCHELL: All right. Mr. Jeffries, any from you?

MR. JEFFRIES: No questions, Madam Chair.

CHAIR MITCHELL: All right. At this point in time, we will entertain motions.

MR. DODGE: Chair Mitchell, this is Tim Dodge with the Public Staff.

CHAIR MITCHELL: All right. Mr. Dodge.

MR. DODGE: During my cross examination of Mr. Spanos yesterday, I asked that Public Staff Exhibit 36 be marked as Public Staff Spanos Rebuttal Exhibit 1. And in so naming, I neglected to recognize that the witnesses were appearing as a panel. I believe Ms. Holt also followed suit. So to clarify the record, I request that the three Public Staff Spanos rebuttal cross exhibits be relabeled as Public Staff Spanos/Doss Rebuttal Cross Exhibits 1 through 3.

CHAIR MITCHELL: All right. Mr. Dodge, thank you for that clarification. The three Public

Staff cross examination exhibits will be -- will be labeled as Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits numbers 1, 2, and 3.

(Public Staff Spanos Cross Examination Exhibit Numbers 1 and 2 and Public Staff Spanos Rebuttal Cross Examination Exhibit Number 3 were remarked as Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits numbers 1, 2, and 3.)

MR. DODGE: Thank you. And with that, I would also request that those three exhibits be admitted into evidence.

CHAIR MITCHELL: All right. Hearing no objection to that motion, Mr. Dodge, it will be allowed.

(Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits numbers 1, 2, and 3 were admitted into evidence.)

MR. GRANTMYRE: This is Bill Grantmyre, Public Staff. I would request that Public Staff Doss Rebuttal Cross Examination Exhibits 1 and 2 be admitted into evidence.

CHAIR MITCHELL: All right. Well,

Mr. Grantmyre, as Mr. Dodge and I have just been discussing, because they were -- because Doss and Spanos were a panel and Mr. Dodge has asked that the exhibits be labeled as Doss Spanos, let's do this. Actually, you're about to say something, so proceed.

MR. GRANTMYRE: Yes. I would request that instead of Doss 1 and 2, they be renumbered Spanos/Doss Exhibits 3 and 4 -- I'm sorry, 4 and 5.

CHAIR MITCHELL: All right. The documents will be relabeled as Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits Numbers 4 and 5.

(Public Staff Doss Rebuttal Cross Examination Exhibit Numbers 1 and 2 were remarked as Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits Numbers 4 and 5.)

MR. GRANTMYRE: Thank you.

CHAIR MITCHELL: And Mr. Grantmyre and Mr. Dodge, I would ask that you keep a close eye on these documents and just work with our court reporter to ensure that they are appropriately labeled in light of the relabeling that is occurring.

MR. GRANTMYRE: Thank you.

MR. DODGE: Thank you.

CHAIR MITCHELL: All right. Mr. Grantmyre, did you -- did you move those documents into evidence?

MR. GRANTMYRE: I believe so, but I will do it again. I will move those documents into evidence. Thank you.

CHAIR MITCHELL: All right. Hearing no objection to that motion, Mr. Grantmyre -- Mr. Marzo, are you objecting?

MR. MARZO: You know, I just -- same objection before. Just a lack of authentication to those documents, because those are documents that Mr. Doss really could do nothing more than to read the information on the document.

CHAIR MITCHELL: All right. Well, noting your objection, Mr. Marzo, I'm going to allow the documents to be admitted into evidence.

(Public Staff Doss/Spanos Rebuttal Cross Examination Exhibits Numbers 4 and 5 were admitted into evidence.)

CHAIR MITCHELL: All right. Any

additional motions from the parties?

MR. MARZO: Chair Mitchell, I ask that the supplemental testimony and the rebuttal testimony of David Doss and his exhibits be entered into the record.

CHAIR MITCHELL: All right. Hearing no objection, Mr. Marzo, your motion is allowed.

(Doss Rebuttal Exhibit 1 and Doss Supplemental Exhibit 1 were admitted into evidence.)

MR. JEFFRIES: And, Madam Chair, just for the sake of the clarity of the record, Mr. Spanos had no exhibits to his rebuttal testimony.

CHAIR MITCHELL: All right. Thank you, Mr. Jeffries.

All right. With that, Mr. Doss -- any additional motions?

MS. FORCE: Chair Mitchell, I move that AGO Doss/Spanos Rebuttal Cross Exhibit 1 be admitted into evidence.

CHAIR MITCHELL: All right. Ms. Force, hearing no objection to your motion, it is allowed.

MS. FORCE: Thank you.

(AGO Doss/Spanos Rebuttal Cross Examination Exhibit 1 was admitted into evidence.)

CHAIR MITCHELL: Okay. With that, Mr. Doss and Mr. Spanos, you may step down. We appreciate your testimony this morning.

THE WITNESS: (John J. Spanos) Thank you.

CHAIR MITCHELL: And I believe, for clarity, your witnesses are excused as well.

All right. Mr. Heslin, you are up.

MR. HESLIN: Yes. Good afternoon or good morning, Chair Mitchell. I call Sean Riley to the stand.

CHAIR MITCHELL: All right. Good morning, Mr. Riley. Let's get you sworn in.

Whereupon,

SEAN P. RILEY,

having first been duly affirmed, was examined and testified as follows:

CHAIR MITCHELL: All right. Thank you. You may proceed, Mr. Heslin.

MR. HESLIN: Thank you, Chair Mitchell.

DIRECT EXAMINATION BY MR. HESLIN:

Q. Mr. Riley, can you state your full name and address for the record, please?

A. Sean Patrick Riley. 601 South Figueroa, Los Angeles, California.

Q. And what company do you work for?

A. PricewaterhouseCoopers, sometimes referred to as PwC.

Q. And can you provide a short description of your role with the company.

A. I am a partner in PwC's national power and utilities practice. I have several roles in the Company. I am an audit partner serving large regulated utility audit clients, as well as I lead what's called our complex accounting and regulatory solutions practice. And as part of that, we provide consulting services to regulated utilities across the US.

Q. Thank you. And on March 4, 2020, did you cause to be filed, rebuttal -- prefiled rebuttal testimony consisting of 33 pages and one exhibit?

A. Yes.

Q. Do you have any corrections to your testimony or exhibit?

A. I do not.

Q. If I asked you the same questions today, would your answers be the same?

A. Yes.

Q. And did you prepare a summary of your testimony?

A. I did.

Q. Thank you, Mr. Riley.

MR. HESLIN: Chair Mitchell, at this time, I would move that Mr. Riley's prefiled rebuttal testimony and his summary, which was provided to parties and the Commission previously, be entered into the record as if given orally; and that Riley Rebuttal Exhibit 1 be marked for identification.

CHAIR MITCHELL: All right. Hearing no objection, Mr. Heslin, the motion is allowed.

(Riley Rebuttal Exhibit 1 was identified as they were marked when prefiled.)

(Whereupon, the prefiled rebuttal testimony and summary of testimony of Sean P. Riley was copied into the record as if given orally from the stand.)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Sean P. Riley. My business address is PricewaterhouseCoopers LLP, 601 South Figueroa Street, Los Angeles, CA 90017.

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS REBUTTAL TESTIMONY?

A. I am submitting this rebuttal testimony on behalf of Duke Energy Carolinas, LLC ("DE Carolinas," or the "Company").

Q. PLEASE DESCRIBE YOUR OCCUPATION AND WORK EXPERIENCE.

A. I graduated from the University of Vermont in 1990 and was hired by Coopers & Lybrand (predecessor company to PricewaterhouseCoopers LLP (PwC) in 1992 as an auditor focused on the financial statement audits of regulated utilities. PwC is the largest professional services network in the world, providing audit, tax and advisory services to the largest and most complex companies globally. I was admitted to the partnership of PwC in 2004. I am a certified public accountant (CPA) currently licensed in the States of California, Maine and Massachusetts.

I am a member of PwC's National Power, Utility and Renewable Energy Practice. Our nationally recognized practice is viewed as a leader in the Utilities sector, and comprises over 1,300 professionals, including professionals notably experienced in serving rate regulated entities. We serve all of the largest and most complex regulated utilities in the United States.

I currently have two roles within our Utility practice. First, I am an Assurance Partner leading significant financial statements and internal controls over financial reporting audit engagements in the Power and Utility sector. In addition, I lead PwC's Complex Accounting and Regulatory Solutions (CARS) practice. In this role, I oversee a team of highly experienced Utility sector specialists that advise clients on complex technical accounting and regulatory / ratemaking matters. In addition, our CARS team is responsible for the development of thought leadership related to the Power and Utilities Sector.

I previously completed a three-year tour as the Power and Utility technical accounting leader in the Accounting Services Group within PwC's National Office. I am a frequent speaker at PwC utility industry events, as well as for organizations such as the Edison Electric Institute and American Gas Association.

Q. HAVE YOU DEALT WITH THE UNIQUE ACCOUNTING AND FINANCIAL REPORTING ISSUES ENCOUNTERED BY REGULATED ENTERPRISES?

A. Yes. Throughout my career, I have focused on utility accounting and regulatory /ratemaking issues primarily as a result of auditing regulated enterprises. The unique generally accepted accounting principles ("GAAP") applicable to regulated entities embodied in Accounting Standard Codification ("ASC") 980 *Regulated Operations* (previously known as Statement of Financial Accounting Standard ("SFAS") 71, *Accounting for the Effects of Certain Types of Regulation*) and related standards all need to be understood so that auditors can determine if a company's accounting has been applied appropriately. During my career, I have consulted with utilities, and internally with other PwC engagement teams, as to how these standards should be applied.

Q. HAVE YOU PROVIDED TRAINING ON THE APPLICATION OF GAAP TO REGULATED ENTERPRISES?

A. Yes. I have developed and presented utility accounting seminars focusing on the unique aspects of the regulatory process and the resulting accounting consequences of the application of Generally Accepted Accounting Principles ("GAAP"). I have presented at seminars as well as delivered training on an in-house basis. I have also presented at various Edison Electric Institute and American Gas Association ratemaking and accounting seminars.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.

A. My testimony will address the following items: (1) Describe the applicable GAAP for rate regulated entities such as Duke Energy Carolinas, LLC ("DEC") under which the accounting follows the ratemaking; (2) Describe the accounting for Asset Retirement Obligations under ASC 410, *Asset Retirement and Environmental Obligations* (formally known as SFAS 143, *Accounting for Asset Retirement Obligations* ("SFAS 143") and FASB Interpretation 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47")); (3) Describe how regulators permit recovery of expenditures / costs and the GAAP accounting for such actions. Costs are often recovered in the ratemaking process after they have been incurred but are also recovered in certain circumstances in advance of the actual expenditures; and (4) Summarize DEC's accounting for coal ash remediation efforts and the related ratemaking history.

Q. DOES YOUR TESTIMONY INCLUDE ANY EXHIBITS?

A. Yes. Riley Rebuttal Exhibit 1 includes my educational and professional background.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. My testimony concludes that DEC's accounting for coal ash costs, the history of which has been described to us by the Company's management, is appropriate under GAAP, which are required to be followed by registrant companies of the Securities and Exchange Commission (SEC) such as DEC. Further, DEC's depreciation expense is also consistent with GAAP because such accounting follows the ratemaking treatment for such costs. [1]

II. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES APPLICABLE TO RATE REGULATED ENTITIES

Q. BEFORE DISCUSSING THE SPECIFIC ISSUE OF DEC'S ASH POND COST RECOVERY, CAN YOU PROVIDE A BACKGROUND ON THE APPLICATION OF GAAP TO RATE REGULATED ENTITIES SUCH AS DEC?

A. Yes**.** GAAP provide the framework for measuring and reporting assets, liabilities, revenues and expenses in financial statements. They present a "common yardstick" for investors and others who are interested in the financial

[1] This testimony was prepared in connection with the filing of Duke Energy Carolinas with the North Carolina Utilities Commission and for the use and benefit of Duke Energy Carolinas. PwC disclaims any contractual or other responsibility to others based on their access to or use of testimony and the information contained herein.

condition and results of operations so that investors can evaluate the entity, for among other things, potential investment. The Financial Accounting Standards Board ("FASB") and predecessors promulgate accounting principles for various transactions. Periodic reporting of results under GAAP for publicly traded entities occur through Annual Reports to investors and other stakeholders (for example, state and federal regulators, including the SEC, the agency responsible for protecting investors). While GAAP presents a common yardstick for accounting and reporting, there are certain industries where GAAP takes into account the unique nature of such industry so that the appropriate financial results are presented in a way that reflect the differing economic consequences of that industry.

Q. DOES RATE REGULATION CREATE UNIQUE ECONOMIC CONSEQUENCES THAT NEED TO BE CONSIDERED WHEN PRESENTING FINANCIAL RESULTS UNDER GAAP?

A. Yes. Under traditional rate regulation, the prices charged for services provided by utilities (electric, gas and water entities) are regulated (subject to review and approval) by a state's regulatory commission and / or the Federal Energy Regulatory Commission ("FERC"), as applicable. This is because such entities provide a necessary service and operate as monopolies. Without such regulation, the monopoly utility could charge whatever they could, and would therefore earn "super-monopoly" profits. Instead, the regulatory compact permits the utility to operate in a specific service territory and in return, the regulatory commission regulates various aspects of the utility, including pricing.

The prices charged by a rate-regulated utility are based on the utility's cost of providing service, including both capital and operating costs. Capital costs include a return on investment to utility investors measured as the allowed rate base times an allowed rate of return. Operating costs include the costs of providing service to customers and include operating expenses, maintenance expenses, depreciation and taxes, among others. A rate case is the vehicle for presenting costs to a regulator for recovery and determining the revenue requirement of a utility.

Q. HOW DOES RATE REGULATION IMPACT GAAP?

A. In the ratemaking process, the regulator can decide to permit recovery of a cost in a period that is different from when GAAP would require such cost to be reported. For enterprises in general, there is no direct link between expenses and revenues. Revenues / prices are based on what the market will bear. Because rate-regulated utilities are not subject to competition, the regulator acts as a substitute for competition and requires rate cases for the utility to present its costs for the development of its revenue requirement (prices). Under this unique rate-regulation mechanism, there is a matching of revenues and costs that should be reflected in the utility's financial statements. This is accomplished via ASC 980, *Regulated Operations* (ASC 980), which includes the concepts of the initially issued pronouncement, Statement of Financial

Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS 71).

Q. WHAT IS ASC 980 AND ITS PREDECESSOR STATEMENT SFAS 71?

A. SFAS 71 was issued by the FASB in 1982. This Statement was the primary accounting principle that provided accounting guidance for rate regulated entities and addressed the unique accounting for entities where there is a linkage between rates or tariffs charged to its customers and a rate regulated company's cost. A rate regulated enterprise's costs are defined to include the costs of capital, both debt and equity.

Under SFAS 71, utilities are required to defer incurred costs that non-regulated entities would charge to expense if, as a result of the regulatory process, it is probable that such costs will be recovered in future charges to ratepayers. Additionally, rate regulated entities are required to record regulatory liabilities when it becomes probable that a regulator will require the refund of revenues previously charged to and collected from ratepayers. The FASB codified the concepts of SFAS 71 within ASC 980 *Regulated Operations* in September of 2009.

Q. WHAT ARE THE REQUIREMENTS FOR APPLYING ASC 980?

A. ASC 980-10-15-2 provides the specific scope requirements. Entities with regulated operations that meet all of the following criteria are required to apply ASC 980 to the general purpose-external financial statements of its regulated operations.

a. The entity's rates for regulated services or products provided to its ratepayers are established by, or are subject to, approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

b. The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products.

c. In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.

Q. GENERALLY, WHICH TYPES OF ENTITIES FOLLOW THE ACCOUNTING UNDER ASC 980?

A. Historically, rate regulated electric, gas and water utilities followed the accounting requirements of ASC 980. Unlike competitive entities, where the rates / prices charged for products or services are based on competition, rate regulated entities typically set the rates they charge their customers based on their costs, as determined in a rate case in which test year operating and capital costs were presented to a regulator, with a revenue requirement based on costs ultimately ordered. Utilities typically have exclusive right to and were required to provide service in their authorized jurisdiction in exchange for the Commission's oversight of a number of operational and financial factors, such as determining the rates that could be charged to customers. The economic effects of regulation were considered unique by the FASB when they considered the accounting that eventually resulted in ASC 980.

Said another way, because rate regulated utilities are permitted to charge revenue based on costs, their financial statements should recognize the direct linkage between costs and revenues. Further, if a regulator permits recovery (revenue) of a cost subsequent to an accounting period when the actual cost was incurred, that cost should be deferred on the balance sheet (rather than expensed in the income statement) and amortized to the income statement in the period in which the revenues to recover that cost are being reflected. This accounting matches the costs (expenses) and revenues (based on those costs).

The important point here is that, for utilities, accounting follows ratemaking, not the other way around.

Q. CAN YOU PROVIDE A SIMPLE EXAMPLE OF HOW ASC 980 IS APPLIED?

A. Yes. Assume a hurricane occurs in 2019 resulting in considerable damage to two entities. One entity is a rate regulated utility and the other is a maker of widgets. Both entities spend $20 million performing a variety of storm restoration and maintenance activities to repair the damage caused by the hurricane. Under GAAP, both entities would record $20 million of maintenance expense in 2019 as both companies incurred $20 million of maintenance costs in the period.

The widget maker presumably would not be able to pass along the $20 million maintenance expense in the price of widgets because widget prices are set by the competitive widget market where there is no direct correlation between current costs and future revenues. Thus, that company would likely report that its net income in 2019 was lower than expected due to the hurricane. The regulated utility company would likely seek recovery of this cost from its regulator. Precedent would play an important role in determining whether rate actions of the regulator would permit future rate recovery of the storm costs. If the utility concluded that recovery of the $20 million was probable (i.e., greater than a 75% likelihood of recovery), it would reverse the $20 million of maintenance expense (remove from the income statement) and record a regulatory asset (add to the balance sheet). The regulatory asset would then be charged to expense (amortized) in the period that the regulator permitted recovery of the asset through rates. So, if the regulator permitted recovery of the $20 million storm restoration and maintenance at the rate of $5 million per year for four years beginning in 2020, the utility would amortize $5 million of the regulatory asset each year as maintenance expense to match the $5 million of additional revenues granted to recover that cost.

Q. IN YOUR EXAMPLE, THE UTILITY DOES NOT REPORT AN EXPENSE IN ITS 2019 INCOME STATEMENT LIKE THE WIDGET COMPANY BUT DEFERS THAT COSTS ON ITS BALANCE SHEET (AS A REGULATORY ASSET) AND AMORTIZES THAT COST TO THE INCOME STATEMENT IN THE PERIODS IT IS BEING RECOVERED IN REGULATED RATES. IS THAT BECAUSE OF COST-BASED RATE REGULATION?

A. Yes. SFAS 71 as originally issued noted:

> *"This Statement may require that a cost be accounted for in a different manner from that required by another authoritative pronouncement. In that case, this Statement is to be followed because it reflects the economic effects of the rate-making*

process—effects not considered in other authoritative pronouncements. All other provisions of that other authoritative pronouncement apply to the regulated enterprise."

The ratemaking process provides a linkage between costs and revenues creating an economic effect which is reflected in GAAP financials for rate regulated entities. ASC 980 has been in effect for many years and the concept of regulatory assets and regulatory liabilities is not a new one. If the conditions of ASC 980 are met, regulated entities will recognize a regulatory asset or liability whenever expenses or revenues are recognized in one period for regulated ratemaking but would have been recognized in another period under GAAP for an unregulated entity.

The important point here is that the GAAP accounting for rate-regulated utilities follows the ratemaking process to reflect the unique, economic consequences of rate regulation.

Q. ARE THERE OTHER EXAMPLES YOU CAN CITE ON HOW ASC 980 IS APPLIED?

A. Utilities with automatic fuel adjustment clauses defer actual fuel expense as regulatory assets or liabilities so that the fuel expense in the income statement reflects the fuel expense collected through current rates. Fuel costs in excess of the amount collected through current rates are deferred until the period in which it is charged to customers. In addition, pension costs, as determined under GAAP, are sometimes recovered by regulated entities in periods different than when they charged to expense by enterprises in general. Again, such difference between the GAAP expense and ratemaking recovery is deferred by regulated entities as regulatory assets or liabilities.

Q. WHEN UTILITY INVESTORS SUPPLY THE FUNDING FOR EXPENDITURES PRIOR TO RECOVERY FROM CUSTOMERS, IS A RETURN GENERALLY PERMITTED ON SUCH A REGULATORY ASSET UNTIL RECOVERY HAS OCCURRED?

A. Yes. In utility accounting and ratemaking there is a concept of "recovery of" and "return on" investment. Simply stated, recovery of the investment means the investor receives cost recovery. This is best illustrated by referring to the investment in property, plant and equipment. An investment in a generating facility, for example, requires capital investment on the front end to acquire or construct the facility. The investor recovers their investment as the plant is depreciated and the customers pay the revenue requirement (which includes depreciation expense). In addition, the undepreciated cost (i.e., the remaining net book value) of the plant is included within rate base and earns a return. In this manner, over the asset's life, the investor receives their money back and earns a return on their investment until fully recovered.

The same concept applies to other investor funding where recovery occurs over time in order to compensate the investors for the time value of their funding. In the hurricane example above, this would result in the regulatory commission permitting a return on the unamortized regulatory asset until such balance has been recovered to reflect the upfront cost of financing provided by the utility investor.

Q. WHAT IF INVESTORS DO NOT RECEIVE BOTH RECOVERY OF AND RETURN ON THEIR INVESTMENTS?

A. If investors do not receive both recovery of and return on investment, it increases investment risk and, all other things being equal, may increase a company's cost of capital. As capital-intensive industries, such as utilities, require significant capital investment, not permitting an adequate return on investment may impact a company's ability to attract capital. As most utility investment funding is both recovered and receives a return, capital investment that does not recover both is at a competitive disadvantage.

III. ASC 410 ASSET RETIREMENT AND ENVIRONMENTAL OBLIGATIONS

Q. WHAT ARE THE REQUIREMENTS OF ASC 410 UNDER GAAP?

A. ASC 410 establishes the GAAP standard to account for legal retirement obligations. The Standard became effective in 2003 and requires an entity to determine if it has a present legal obligation to remove, dispose, or remediate an asset. If a legal obligation presently exists, the fair value of the legal obligation is to be recorded as an Asset Retirement Obligation (ARO) with a corresponding Asset Retirement Cost (ARC) recorded as well. The initial accounting journal entry is as follows:

Dr. ARC XXX

Cr. ARO XXX

The entity would then depreciate the ARC asset and accrete, or increase, the ARO liability through the estimated retirement date, such that when the retirement cost is paid, the ARC asset would have been fully depreciated and the ARO liability would have increased to the amount of the full obligation. Both ARC depreciation expense and ARO accretion expense are recorded on the income statement over time to recognize the estimated costs of settling the legal obligation in the periods that the related asset is being used, unless deferral authority is granted by a regulatory commission in the case of a rate regulated entity. As a result, when the underlying asset reaches the end of its useful life, the Asset Retirement Obligation would represent (i.e., be equal to) the cost to settle the obligation at that time.

Q. HOW DOES ASC 410 DEFINE LEGAL AROS?

A. ASC 410 is the codification of the concepts contained within SFAS 143 *Accounting for Asset Retirement Obligations.* SFAS 143 became effective in 2003, with a scope that included the costs of "legal obligations associated with the retirement of a tangible long-lived asset." Specifically, "The statement only applies to costs related to the retirement of a tangible long-lived asset resulting from "acquisition, construction, or development and (or) normal operation of a long-lived asset." The definition was expanded by Financial Interpretation (FIN) 47 *Accounting for Conditional Asset Retirement Obligations - An Interpretation of FASB Statement No. 143* to include "conditional" obligations to remove or dispose of assets.

Common AROs in the electric utility industry include decommissioning of nuclear plants and some coal plants at the end of or after their useful lives, state requirements to safely close ash ponds and costs to remove asbestos from facilities. The retirement activities for the majority of the utility industry's assets have not been classified as AROs (and do not meet the accounting requirements of ASC 410) because they are not legal obligations (i.e., there is no legal obligation to retire an asset). However, this does not mean that removal costs on such assets will not be incurred. GAAP requires that non-legal retirement costs be recognized when incurred, prior to consideration of any ratemaking impacts and the effect of ASC 980.

Q. PLEASE DESCRIBE IN MORE DETAIL HOW THE INITIAL ARO LIABILITY AND ASSET RETIREMENT COST ASSET ARE DETERMINED UNDER ASC 410?

A. The process to determine the ARO liability begins with estimating the future cost associated with the cost of the legal obligation. The estimated future cost is then discounted using a "credit-adjusted risk-free rate." The discounted future obligation is recorded on the balance sheet (credit) with an equal increase in the fixed asset balance for the ARC asset at the time the property is placed in service (debit).

This ARC asset amount is depreciated on a straight-line basis through depreciation expense. The discounted ARO liability is increased each year through an accretion expense charge such that the initial ARO liability amount will increase to the ultimate cost to remove the asset by the estimated removal date (which may be at or several years after the date the asset is retired).

Q. DOES ASC 410 DISTINGUISH BETWEEN THE ACCOUNTING FOR LEGAL ASSET RETIREMENTS VERSUS NON-LEGAL ASSET RETIREMENTS?

A. Yes. ASC 410 concludes that legal AROs should be recorded in the financial statements. Asset retirements, where there is no legal requirement associated with the retirement of the asset, were excluded from the accounting required by ASC 410. The FASB has paid increasing attention to the Balance Sheet presentation of assets and liabilities. The main thrust behind ASC 410 is to require that all legal liabilities of an entity are recorded on the Balance Sheet. Thus, the discounted value of the legal liability to remove an asset is recorded on the Balance Sheet of all entities at the same time the asset is placed into service, or when the legal obligation arises, if later.

Q. WITH THAT BACKGROUND ON THE ASC 410 GAAP ACCOUNTING, HOW ARE SUCH COSTS GENERALLY TREATED IN THE RATEMAKING PROCESS?

A. Generally, regulators ignore ASC 410 for ratemaking purposes. Neither the ARO liability nor the ARC asset are included in rate base, and ARC depreciation and ARO accretion are excluded from operating expenses. While the ARO liability and ARC asset are presented on the Balance Sheet, they result from accounting journal entries, not investor or customer contributions (and therefore are not considered for ratemaking purposes until the point that actual removal costs are expended upon the retirement of the asset).

Q. DOES THIS MEAN THAT LEGAL REMOVAL COSTS ARE NOT RECOVERED FROM CUSTOMERS IN THE RATEMAKING PROCESS?

A. No, quite the opposite. As with all reasonable and prudently incurred costs incurred by a utility, costs to remove assets upon retirement are almost always recovered; however, the mechanism of recovery can vary. Sometimes these costs are recovered from customers over some period of time after removal expenditures are spent, and other times they are estimated and recovered from customers in advance of the actual expenditure through an estimated cost of removal concept - a regulatory mechanism that I will describe shortly.

Q. ARE LEGAL REMOVAL COSTS ALWAYS RECOVERED VIA COST OF REMOVAL?

A. No. As I mentioned previously, decommissioning of nuclear plants is a common utility ARO. Frequently, such costs are collected via a nuclear decommissioning surcharge which operates differently from the traditional cost of removal concept. For all costs, it is ultimately up to the regulator to determine if costs are prudently incurred and recovered from customers. Once it is determined that a cost is prudently incurred and should be recovered, it is then up to the regulator to determine the method of recovery. This is an important point. Accounting does not drive cost recovery, but rather cost recovery drives the accounting under ASC 980.

Further, as noted in Company Witness Spanos's testimony:

"Prior to approximately the mid-2010s, and particularly in connection with the promulgation of the US Environmental Protection Agency's final rule on coal combustion residuals ("CCR Rule"), ***it was not standard industry practice to include anticipated costs of coal ash impoundment closure in net salvage portion of depreciation expense for several reasons****. In the early part of the period specified in DR 1 above, it was not common to have decommissioning studies performed that included coal burning facilities because the prevailing presumption by electric companies at that time was that such facilities would continue to provide power in same function [sic, should read "some fashion"] well into the future. Moreover, ash basins would continue serving their function of holding CCRs, and would in that connection continue to be managed and permitted. Without a definite plan to decommission these plants, or the specific manner at which the facility will be decommissioned, it was not appropriate to include decommissioning costs related to coal ash basin closures in the calculation of depreciation rates. Further, as a general matter, pre-CCR Rule coal ash basin closures ordinarily were planned and carried out in conjunction with the relevant environmental authorities. While DEC began assessing the requirements for and anticipated costs of coal ash basin closure in the years immediately prior to the promulgation of the CCR Rule and enactment of North Carolina's Coal Ash*

Management Act (CAMA), as evidenced, for example, by AGO Fountain Direct Cross Ex. 6 and AGO Late Filed Ex. 1(L) in Docket E-7, Sub 1146, there was no clarity from federal or North Carolina environmental authorities as to how closure would be accomplished, rendering any cost estimations speculative. Further, following the enactment of CAMA and promulgation of the CCR Rule, which were the triggering events for the establishment of coal ash basin closure AROs, the applicable accounting rules shifted to ARO accounting."

Based on my experience, Mr. Spanos's characterization of how utilities generally treated the costs of CCR remediation for ratemaking purposes was consistent with industry practice prior to the enactment of the federal CCR Rule.

Furthermore, prior to the issuance of the CCR rules, <u>not</u> recording an ARO liability for coal ash ponds was consistent with industry practice. As noted in Spanos's testimony, there was uncertainty surrounding the potential date or range of dates of retirements of the ash ponds, as it was considered likely they would continue to be used in future periods at the sites. ASC 410-20-25-7, 8 and 9 address these types of conditional obligations and acknowledge that there will be instances in which an entity does not have the information to reasonably estimate the fair value of an asset retirement obligation and that it is a matter of judgement dependent on an entity's relevant facts and circumstances. As such, it is not unusual that there was disparity in the timing of recording of ARO liabilities related to ash ponds due to each individual utility's facts and circumstances.

Q. DOES ASC 410 CONTAIN GUIDANCE ON THE RATEMAKING TREATMENT OF LEGAL ARO LIABILITIES OR OTHER NON-LEGAL COSTS OF REMOVAL?

A. No. ASC 410 and other FASB pronouncements do not address ratemaking treatment; ASC 980 addresses the accounting based on ratemaking treatment. However, ASC 410 acknowledges that many regulated entities recover asset retirement costs differently than how GAAP may recognize the related expense. Discussing rate-regulated entities, ASC 410 states:

> *"The amounts charged to customers for the costs related to the retirement of long-lived assets may differ from the period costs recognized in accordance with this Statement, and, therefore, may result in a difference in the timing of recognition of period costs for financial reporting and rate-making purposes."*

ASC 410 further recognizes that if the requirements for ASC 980 are met, the rate-regulated entity would recognize for financial accounting purposes a regulatory asset or liability for the differences in timing of cost recognition (and related recovery from customers) for ratemaking and financial reporting.

IV. COST OF REMOVAL

Q. WITH THAT EXPLANATION OF THE GAAP ACCOUNTING FOR LEGAL ASSET RETIREMENT OBLIGATIONS, CAN YOU TALK MORE BROADLY ABOUT REMOVAL COSTS AND THE ASSOCIATED RATEMAKING AND ACCOUNTING CONSIDERATIONS?

A. Yes.

Q. WHAT ARE "REMOVAL COSTS?"

A. Removal costs are the costs incurred at the end of an asset's useful life. At that time, there may be a salvage value, a removal cost, or both. An example of salvage value is the amount realized from selling scrap metal resulting from dismantling a fixed asset. Salvage can be differentiated from the costs incurred by the Company to physically remove assets from service upon retirement, safely dispose of the asset and / or restore the site, which are referred to as removal costs (sometimes referred to as "negative salvage"). Certain of these removal costs represent legal obligations. For example, certain sites contain asbestos and many transformers contain polychlorinated biphenyls ("PCBs"). There are environmental laws that govern the removal of asbestos and PCBs when the facility or transformer is retired, each of which comes with a cost. Certain removal costs are not legally required but are incurred for other reasons. For example, when utility poles are retired, they are physically removed from service although there is no legal obligation to do so.

Q. WHAT IS THE ACCOUNTING FOR PROPERTY, PLANT AND EQUIPMENT AND REMOVAL COSTS UNDER GAAP?

A. Under GAAP, the cost of an asset is capitalized and depreciated over its estimated useful life in a systematic and rational manner (generally on a straight-line basis), such that at the end of its useful life the plant asset has been fully recovered through depreciation charges. As previously stated, when the asset is retired, there can be a salvage value, a cost to remove or dismantle the fixed asset, both, or neither.

Based on GAAP, all entities need to consider salvage value when determining the annual depreciation charge. The definition of depreciation accounting under GAAP is as follows:

> *"The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated life of the unit (which may be a group of assets) in a systematic and rational manner." ARB No. 43 Paragraph 9-C- 5.*

As noted above, depreciation accounting contemplates allocating the net original cost of the fixed asset (cost of the fixed asset reduced by the estimated salvage value). For example, assume a fixed asset is acquired for $10,000 with an estimated five-year life and an estimated salvage value (at the end of year 5) of $500. The net cost to be recovered through annual depreciation charges is $9,500 or $1,900 each year ($9,500/5). In this manner, the net cost is allocated over the estimated useful life of the fixed asset and each period incurs an appropriate depreciation charge.

Q. DOES GAAP PROVIDE FOR RECOGNIZING THE COST OF REMOVAL OR "NEGATIVE SALVAGE?"

A. No. GAAP does not have any standard that requires cost of removal to be recorded for non-legal removal obligations prior to the removal being performed.

Q. THEN WHAT IS "COST OF REMOVAL ACCOUNTING?"

A. "Cost of removal accounting" is not a term that is defined in GAAP. Rather, I and others who are familiar with regulatory accounting, use this term to describe the ratemaking treatment approved by regulators in certain situations when the cost to remove an asset is recovered over the asset's useful life (and in advance of the actual removal expenditure) and the accounting under ASC 980 for this regulatory mechanism.

Q. HOW DOES "COST OF REMOVAL ACCOUNTING" WORK?

A. Because regulators have granted recovery of cost of removal over an assets' life for certain assets, the regulator allows entities to include an "advanced recovery of removal costs through additional charges to depreciation expense" when developing the revenue requirement. As a result, ASC 980 allows regulated entities to recognize this "removal cost depreciation" for these assets for GAAP to offset the revenue being collected to fund the eventual removal cost.

Q. IF THE REGULATOR ALLOWS FOR THE ADVANCED COLLECTION OF COST OF REMOVAL THROUGH "REMOVAL COST DEPRECIATION", HOW IS THAT ACCOUNTED FOR?

A. As previously noted, there is no GAAP that stipulates how "removal cost depreciation" should be accounted for. Rather, ASC 980 matches the "removal cost depreciation" expense with the revenue requirement that considered "removal cost depreciation" as one of the costs of providing service. An example will help to clarify the accounting. Assume there is a cost basis of an asset of $100 with a 10-year life. Also assume there is a cost of $20 to remove the asset upon retirement. In this example, a non-regulated entity would depreciate the asset itself at $10 per year ($10 per year times 10 years = $100 asset cost) and then recognize $20 of expense when the asset is removed. A regulated entity, only in situations where the regulator approves the recovery of the removal cost over the asset's life through cost of removal depreciation, would recognize $12 of depreciation expense per year (comprised of $10 per year to recover the $100 asset itself which was originally funded by investors and $2 each year to recover, in advance, over 10 years, the $20 estimated cost of removal). While the investor's investment in Property, Plant and Equipment increases rate base, the cumulative "removal cost depreciation" recovered in advance from customers would reduce rate base until the removal is performed, at which time no incremental expense would be recognized as it was recognized over the asset's life.

Q. IF THE REGULATOR DOES NOT GRANT RECOVERY OF REMOVAL COSTS OVER AN ASSET'S LIFE, WOULD IT BE APPROPRIATE FOR THE UTILITY TO RECOGNIZE "REMOVAL COST DEPRECIATION"?

A. No. As I have stated, for regulated entities, accounting does not drive ratemaking; rather, ratemaking drives accounting. ASC 980 allows for a matching of revenue and expenses. If there is no revenue for the collection of cost of removal, there can be no "removal cost depreciation" as this would violate the concepts of ASC 980. Further, as noted within Witness Spanos' testimony, which I cited previously, it was common for utilities to not request recovery of coal ash basin closure related costs as part of removal cost depreciation.

Q. CAN YOU PLEASE SUMMARIZE YOUR OVERVIEW OF ASC 410 AND "COST OF REMOVAL ACCOUNTING" AND HOW THEY IMPACT RATEMAKING?

A. Yes. First, accounting does not impact ratemaking; rather, ratemaking impacts the accounting. All entities, regulated or not, must apply the provisions of ASC 410. However, if it is probable that a regulator will allow recovery of retirement costs for the associated assets at some point in the future, the ARC depreciation and ARO accretion costs are deferred as a regulatory asset. Once the revenues are billed to customers to collect removal costs, via whichever mechanism is approved by the regulator, then the expense is recognized at that point and the regulatory asset is reduced. In contrast, "cost of removal accounting" is not specified in GAAP, but rather is reflected in GAAP financial statements as a result of ASC 980 to mirror the ratemaking approved by a regulator.

V. SUMMARY OF DEC'S ACCOUNTING AND RATEMAKING FOR COAL ASH REMEDIATION

Q. CAN YOU PLEASE SUMMARIZE HOW DEC HAS ACCOUNTED FOR COAL ASH REMEDIATION COSTS PRIOR TO THE ADOPTION OF ASC 410 (SFAS 143) IN 2003?

A. Yes. I understand from Duke's accounting witness Doss that prior to the adoption of SFAS 143, DEC did not recognize any assets or liabilities for coal basin closure costs or other legal obligations to remove assets. This was entirely appropriate as GAAP did not require any different accounting for legal obligations. Further, as the Commission had not approved any rate recovery associated with any such actual or anticipated coal ash basin closure costs, there were no ASC 980 entries to record.

Q. HAD THE NCUC CAUSED DEC TO COLLECT COST OF REMOVAL RELATED TO COAL ASH REMEDIATION, WHAT WOULD HAVE HAPPENED TO CUSTOMER RATES?

A. Customer rates, other things being equal, would have increased commensurate with this new revenue requirement.

Q. HOW DID DEC ACCOUNT FOR COAL ASH BASIN CLOSURE COSTS AS A RESULT OF THE ADOPTION OF SFAS 143 IN 2003?

A. Based on my understanding through discussions with Duke's accounting witness Doss, consistent with other regulated utilities DEC recorded its SFAS 143 accounting entries based on the laws in effect at the time of adoption. DEC concluded that no legal obligation existed at that point in time regarding coal ash basin closure. As a result, no accounting was required for coal ash upon adoption.

Also, consistent with other regulated utilities, in relation to other situations where DEC had a legal retirement obligation at the adoption date of SFAS 143, such as for nuclear decommissioning obligations, DEC recorded a regulatory asset for the cumulative ARC depreciation and ARO accretion expense associated with those legal retirement obligations for amounts that would have been charged historically (but not yet recovered from customers). Future ARC depreciation and ARO accretion were also recorded (added) to this regulatory asset prior to the point of recovering such costs from customers.

Q. YOU SAID THAT TO RECORD A REGULATORY ASSET UNDER ASC 980, THESE COSTS HAVE TO BE PROBABLE OF FUTURE RECOVERY. HOW DID DEC SUPPORT THIS ASSERTION THAT SUCH RECOVERY WAS PROBABLE?

A. At the time of adoption of SFAS 143 in 2003, DEC applied for and received an accounting order from the NCUC signaling the Commission's intent to provide recovery of these legal asset retirement costs[2]. It is common to rely on an accounting order to support a regulatory asset if there is no prior conflicting precedent on point and that evidence supports the probability of recovery from customers in the future. In 2003, DEC concluded there was no such conflicting precedent here and that adequate evidence existed to support the recognition of a regulatory asset based on DEC's assessment that it was probable that the NCUC would provide for recovery of such costs.

Q. WHEN DID DEC REQUEST A MECHANISM TO RECOVER THE COSTS TO CLOSE ITS ASH BASINS?

A. With the passage of the Federal EPA's Coal Combustion Residual ("CCR") rules in 2015 and the North Carolina Coal Ash Management Act ("CAMA") in 2014, DEC concluded that a legal obligation was created. These laws required DEC to perform certain closure efforts that would require significant investment. As a result of the enactment of these laws, DEC appropriately recorded an ARO liability and ARC asset related to its required closure of coal ash basins. Further, in 2016, DEC filed a request for an accounting order to defer the CCR compliance costs that had been incurred from January 2015 to November 2016 of approximately $434.4 million. Subsequently, DEC filed a rate case requesting recovery of CCR and CAMA costs. In June 2018, the NCUC approved recovery of these costs (approximately $554 million) over 5 years with a return on the unamortized balance[3].

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[2] Docket No. E-7, Sub 723, August 2003
[3] Docket No. E-7, Sub 1146

Q. WHAT WAS DEC'S ACCOUNTING FOR THIS RECOVERY?

A. DEC reclassified the actual expenditures related to CCR and CAMA from the ARO regulatory asset and to a "spent" ARO regulatory asset that accrued a debt and equity return. Once these costs were recovered, DEC reduced the "spent" ARO regulatory asset as these amounts had now been collected.

Q. BASED ON THESE ACCOUNTING AND RATEMAKING FACTS, WOULD IT HAVE BEEN APPROPRIATE FOR DEC TO FOLLOW "COST OF REMOVAL" ACCOUNTING FOR CCR COSTS?

A. No. Based on its 2018 Order, the NCUC has indicated its intent to provide for the recovery of CCR and CAMA costs as such amounts were expended. Further, no amounts for future closure costs have been included in DEC's current revenue requirement. As a result, it would be inappropriate to recognize any "removal cost depreciation" without the offsetting recovery in revenue.

Q. ARE YOU SUGGESTING THAT THE NCUC CANNOT APPROVE RECOVERY CCR COSTS IN ADVANCE OF THEM BEING SPENT?

A. Absolutely not. The NCUC can approve whatever regulatory treatment they desire within their statutory limits. However, it is our understanding that they did not. Thus, the accounting must match whatever regulatory treatment is approved.

Q. IS "COST OF REMOVAL ACCOUNTING" UNIVERSALLY APPLIED FOR "NORMAL" ASSET RETIREMENTS SUCH AS UTILITY POLES?

A. No. The majority of regulators apply the ratemaking and accounting treatment for cost of removal as I have described. However, one outlier is the Pennsylvania Public Utility Commission, which has required certain jurisdictional utilities to capitalize incurred costs of removal as a regulatory asset after the removal occurs and has permitted recovery from customers over a future period. It has also required other jurisdictional entities to capitalize the incurred costs of removal as part of the new asset being constructed and is depreciated / recovered over the life of the new asset. These costs are included within rate base and earn a return as investors have financed these asset retirement costs. This example reinforces my primary assertion that for regulated entities, accounting follows ratemaking, not the other way around.

Q. HAVE YOU REVIEWED THE COMMISSION'S RECENTLY ISSUED ORDER IN THE DOMINION ENERGY NORTH CAROLINA ("DENC") CASE, DOCKET NO. E-22, SUB 562, ADDRESSING RECOVERY OF DENC'S COAL ASH BASIN CLOSURE COSTS?

A. Yes. I have reviewed sections of the DENC Order that address Findings of Fact Nos. 56-58, which specifically focus on DENC's accounting for CCR closure costs. On these issues the Commission decided:

- DENC did not account for CCR compliance costs as costs of removal in computing and requesting recovery of its allowance for depreciation expense.
- DENC's failure to incorporate such closure costs as part of its allowance for depreciation expense is contrary to accepted depreciation expense accounting principles.
- It is appropriate to require DENC to properly account for coal ash basin closure costs as part of costs of removal included in its allowable depreciation expense.

Q. WHAT IS YOUR REACTION TO THE COMMISSION'S ORDER IN THIS CASE?

A. While I am not familiar with the exact fact pattern in this case, nor am I familiar with the accounting practices of DENC, I have a different interpretation of GAAP and accepted depreciation expense accounting principles. Assuming that DENC's accounting and ratemaking history is similar to that of DEC's as I have summarized in my testimony, I believe that DENC's accounting would be consistent with GAAP and accepted depreciation expense accounting principles. I am not aware of any accepted GAAP depreciation expense principle to which this practice is contrary. Consistent with my testimony, if DENC had not previously been provided recovery of the associated CCR remediation costs, it would not be appropriate to include such costs in its depreciation expense recognized for GAAP as there would be no matching with the associated revenue for recovery of such costs. As I have previously stated, GAAP, through the application of ASC 980, follows ratemaking, not the other way around.

VI. CONCLUSION

Q. MR. RILEY, CAN YOU PLEASE SUMMARIZE YOUR TESTIMONY AND THE CONCLUSIONS YOU HAVE REACHED?

A. Yes. ARO accounting under ASC 410 is required for all entities, regulated and non-regulated. However, ASC 410 is typically ignored for ratemaking purposes as GAAP does not drive ratemaking. Rather, regulators approve either (1) "cost of removal accounting" which allows regulated entities to accrue "removal cost depreciation" expense to match amounts allowed in revenues under ASC 980, or (2) recovery of such expenditures after they are made, in which case a regulatory asset is recorded under ASC 980. Amounts collected in advance of expenditures are typically recorded in a regulatory liability account (which reduces rate base) while expenditures incurred prior to recovery are recorded to a regulatory asset (which either accrues a return or is recorded in rate base). DEC's accounting and depreciation practices as detailed in my testimony appear to be consistent with GAAP and historical practices with regards to regulated utilities.

Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

Duke Energy Carolinas, LLC
Summary of Rebuttal Testimony of Sean Riley
Docket No. E-7, Sub 1214

My name is Sean Riley and I am a Partner of the U.S. Firm of PricewaterhouseCoopers LLP (also known as "PwC"). PwC is a global network of firms that deliver assurance, tax and consulting services to businesses worldwide. I lead PwC's Complex Accounting and Regulatory Solutions Group within the PwC National Power, Utility, and Renewable Energy Practice.

The purpose of my Rebuttal Testimony in this proceeding is to explain GAAP accounting practices and requirements related to the creation of Asset Retirement Obligations under ASC 410 (formerly known as SFAS 143 and as supplemented by FASB Interpretation 47). I also explain how costs associated with ARO's for public utilities like DEC and DEP are generally recovered through the ratemaking process, or otherwise, and I summarize DEC's accounting for coal ash remediation efforts based on discussions with Duke's accounting personnel and related ratemaking history.

In my rebuttal I explain the unique nature and features of GAAP accounting as applied to regulated utilities such as DEC under ASC 980 which provides a linkage between costs and revenues that does not exist for non-regulated companies, and also places a primary emphasis on regulatory ratemaking in the determination of appropriate accounting treatment.

I also discuss the requirements of ASC 410 which, beginning in 2003, required companies like DEC and DEP to assess on an ongoing basis whether it had a present legal obligation to remove, dispose, or remediate a long-lived capital asset. If so, ASC 410 requires that the fair value of such obligation be recorded as an ARO and that simultaneously an Asset Retirement Cost be capitalized, both of which are reflected on the Company's balance sheet.

Regarding the treatment of CCR costs of removal in depreciation studies, I agree with Mr. Spanos that it was not general industry practice to include those costs in depreciation studies prior to the EPA's adoption of its CCR Rule. This was due to the lack of definitive plans to close coal ash ponds and lack of certainty around what legal requirements would be applicable to such closure before the CCR Rule. Even when it became clear that legal obligations would require remediation of coal ash ponds, different companies, operating under different circumstances, established AROs at differing paces based on their specific judgements at the time.

Regarding inclusion of COR costs in depreciation studies, I would note that the idea of calculating and recovering "negative net salvage" is a regulatory concept that is not founded in GAAP. Instead, if it is allowed by regulators then ASC 980 describes how it should be treated on a company's books.

Based on my understanding of DEC and DEP's accounting for coal plant closure costs, and the Commission's prior orders relative to coal plant closures and CCR remediation, DEC and DEP properly followed GAAP in their treatment of potential costs associated with CCR remediation prior to the passage of the EPA's CCR rule and then appropriately utilized ARO accounting once the remediation obligations associated with coal ash became known and estimable.

MR. HESLIN: Thank you, Chair Mitchell.

Mr. Riley is available for cross examination.

CROSS EXAMINATION BY MR. GRANTMYRE:

Q. There is Bill Grantmyre with the Public Staff. Mr. Riley, on page 7, lines 3 and 4, you state:

"The prices charged by a rate-regulated utility are based on the utility's cost of providing service, including both capital and operating costs."

Would you agree that regulatory Commissions sometimes set rates that do not cover all prudently incurred utility costs?

A. Yes, I would agree.

Q. And one example would be that a percentage of senior executive salaries are sometimes excluded from rate recovery?

A. Yes, that is true. Although I would say that, for many utilities around the country, in many cases utilities follow a holding company structure. So some senior executives sit in the holding company as opposed to the regulated utility, so it really depends on the structure of the utility.

Q. But those senior executives, some of their had salaries would be allocated to the operating utility; is that correct?

A. That's correct.
Q. And you're aware that Commissions have disallowed or had some type of sharing of board of directors' compensation and expenses?
A. Yes.
Q. And also Commissioners have disallowed promotional advertising and lobbying expenses may be excluded from rate recovery?
A. Generally speaking, civic and political activities can be construed as what is called below the line, and therefore are shareholder costs, not ratepayer costs.
Q. And also the unamortized balance of nuclear cancellation costs have been denied a return, haven't they, even though they may have been prudently incurred?
A. I would need some specific examples on that.
Q. Well, Shearon Harris plant that was canceled, wasn't that denied a return back in the '80s? It was a construction plant.
A. I'm not familiar with that situation.
Q. And so there are situations when Commissioners do disallow, in ratemaking, prudently incurred costs, in summary?

A. I'm pausing because you're using the word "prudently." It really depends on the situation, but, in general, if there a disallowance, it's the view of the utility -- I'm sorry, the Commission that such costs were not prudently incurred.

Q. Well, payment to senior executives may be a prudent payment, but there's some sharing with the shareholders, correct?

A. Sure. You were referring to disallowance, so that's what I was explaining to you.

Q. Okay. Now, page 8, you discuss on lines 10 through 13, you discuss how SFAS 71, now ASC 1980 -- I'm sorry, 980, allowed certain costs to be deferred for future recovery instead of expense when incurred, correct?

A. That is correct.

Q. Are you aware that North Carolina is an historical test year jurisdiction?

A. Yes.

Q. And is it fair to say that in an historical test year jurisdiction, an unexpected utility expense would normally be deemed to be recovered in existing rates and not deferred?

A. For purposes of applying ASC 980, if a --

there were various ways of deferring, or bases to defer incurred costs. ASC 980 specifically says that, if an entity determines that an incurred cost, an expense, is considered probable of recovery in the future from ratepayers, and that could be based upon past precedent at that particular utility, with other utilities, or by other means, then such amounts could be deferred as a regulatory asset, because they're, again, considered probable for recovery.

Q. But in ratemaking -- I'm talking about ratemaking rather than the accounting rules -- a utility expense that's incurred in a year would normally be recovered in existing rates, would it not, and not be deferred absent a deferral approval by the Commission?

A. Generally speaking, you would expect cost over service -- cost of service items to be recovered in the year that they're incurred.

Q. And would you agree that, in a jurisdiction like North Carolina, historical test year, the prohibition on retroactive ratemaking would normally bar a utility from recovering in future rates a past cost?

A. I'm not familiar enough with North Carolina law to answer that question.

Q. Do you agree that deferral is an exceptional regulatory tool that protects utilities from a significant drop in rate of return when there is a significant unexpected expense?

A. No. No, that's not the purpose of ASC 980. It's been mentioned in other testimonies. ASC 980 is effectively a matching of expenses with the recovery of those expenses from customers. And so it's in many cases either viewed as -- or Commissions look to either have costs recovered in a particular year or as they're managing rates over a period of time. But I would not call them exceptional.

Q. Are you familiar with General Statute 62-133 that sets out for the Commission what is to be included in rates?

A. I am not.

Q. Well, would you accept, subject to check, that ASC 980 is not mentioned at all in that statute?

A. Subject to check, certainly.

Q. And would you also accept that there's no mention of GAAP in that General Statute 62-133?

A. Subject to check, certainly.

Q. And would you also accept, subject to check, that G.S. 62-133 has no mention of FERC?

A. Again, subject to check, certainly, yes.

Q. Now, you explain that FASB standards apply to regulated utilities on pages 7 to 12.

Do you agree that, for state retail ratemaking, state law takes precedent over FASB standards if the two differ?

A. I would like to clarify that, when you're talking about state law, I believe you're talking about ratemaking and what to charge to ratepayers. GAAP, General Accepted Accounting Principles, in ASC 980 are financial reporting standards, accounting standards for financial reporting for entities such as DEC. And so one doesn't override another. I talk about it in my testimony. Accounting follows ratemaking. So as ratemaking and rates are established, the Company, for purposes of its financial reporting, must apply GAAP, including ASC 980, which would take into account those considerations as it relates to ratemaking.

Q. Now, would you agree that, without deferral, the ongoing accretion and depreciation expenses for ARO coal ash costs would not be recovered in an historical test year jurisdiction?

A. I'm sorry, you said without deferral, sir?

Q. Yes.

A. Yes, that is correct.

Q. So is it fair to say that, when a regulatory Commission allows a deferral of coal ash closure costs, it changes the ratemaking treatment that would otherwise have occurred under FASB ASC 410?

A. I'm sorry, sir, can you repeat the question again?

Q. So is it fair to say, when a regulatory Commission allows deferral of coal ash closure costs, it changes the ratemaking treatment that otherwise would occur under the application of FASB ASC 410; would you agree with that?

A. I would. But I'd just clarify, I got confused at the last part of your -- ASC 410 deals with accounting for asset retirement obligations. Ratemaking is outside of ASC 410. ASC 410 does not drive the ratemaking associated with asset retirement obligations.

Q. And I would turn you to page 10. You've already testified to some of this, but we'll go through it very quickly. Page 10, line 7 and 8, would you please read that into the record, the line 7 that begins with "the important point"?

A. Certainly.

"The important point here is that, for utilities, accounting follows ratemaking, not the other way around."

Q. And if we could go to page 12, lines 12 through 14, could you read that into the record?

A. Yes.

"The important point here is that the GAAP accounting for rate-regulated utilities follows the ratemaking process to reflect the unique economic consequences of rate regulation."

Q. And on page 17, line 16, can you read that first sentence beginning with "generally"?

A. "Generally, regulators ignore ASC 410 for ratemaking purposes."

Q. And also on page 21, line 4, I'll read the question if you could read the first two sentences.

"Does ASC 410 contain guidance on the ratemaking treatment of legal ARO liabilities or other nonlegal costs of removal?"

If you would read the answer.

A. Answer:

"No. ASC 410 and other FASB pronouncements do not address ratemaking treatment. ASC 980 addresses the accounting based on ratemaking treatment."

Q. And it also says, the next, line 6 and 7 -- could you read line 6 and 7?

A. "However, ASC 410 acknowledges that many regulated entities recover asset retirement costs differently than how GAAP may recognize the related expense."

Q. Now, on -- you're PricewaterhouseCoopers; is that correct?

A. That's correct.

Q. And on PricewaterhouseCoopers' audited financial statements, what is the sentence they use that says that the company complies with GAAP -- they issue an unqualified opinion that they comply with Generally Accepted Accounting Principles; what is that wording, do you remember?

A. Well, PricewaterhouseCoopers is a private company and we're not audited. But if you're asking --

Q. No. When they issue an audit opinion, I'm sorry.

A. Oh, I see, I see, yes. When we issue an audit opinion -- well, effectually -- and what an audit opinion is, is an independent audit firm, such as PricewaterhouseCoopers -- and we are, by the way, not the auditors of Duke. If we were to issue an opinion on DEC, for example, if it's considered unqualified, it means they're complying with Generally Accepted Accounting Principles and that the financial statements are fairly presented in all material respects.

Q. And the audit -- audit reports also have footnotes that explain unusual circumstances; isn't that correct?

A. I wouldn't call them unusual circumstances. In accordance with Generally Accepted Accounting Principles, there are required disclosures following all of the generally accepted accounting principles that apply to a particular entity, and that's what companies would include in their footnotes.

In addition, as a public company, the SEC also has additional disclosures that are required on publicly filed financial statements.

Q. But the Commission's ratemaking treatment on ARO costs can be described in a footnote very successfully in an audited financial statement; can it not?

A. Yes. For regulated utilities, there would be a footnote, typically titled regulatory assets and liabilities. And within there, there would be a description of regulatory assets and liabilities recognized.

Q. And that could explain the ratemaking treatment for the differential that may be different from GAAP or FERC; is that correct?

A. That's correct.

MR. GRANTMYRE: I have no further questions.

CHAIR MITCHELL: All right. Attorney General's Office?

MS. FORCE: No questions. Thank you.

CHAIR MITCHELL: All right. Any additional cross examination for this witness?

(No response.)

CHAIR MITCHELL: All right. Redirect for the witness.

MR. HESLIN: Yes. Thank you, Chair Mitchell.

REDIRECT EXAMINATION BY MR. HESLIN:

Q. Mr. Riley, you received some questions from Mr. Grantmyre about ARO accounting, and in previous testimony we've heard about how the Commission or ARO accounting in this instance aligns with applications and orders related to coal ash recovery, and then the recognition in 2018 by the Commission that the Company had no choice in the matter but to use ARO accounting.

But can you explain the process for creating AROs, their requirements, and how it fits into the ratemaking process?

A. Certainly. So bear with me in terms of the discussion of journal entries. But when you step back, what FAS 143 required, and then FAS 143 became ASC 410, it required that for legal retirement obligations, that companies must recognize those legal retirement obligations on their books and records. Prior to the issuance of FAS 143, there was diversity in practice in terms of companies recognizing or not recognizing legal retirement obligations.

What the standard requires is that, to the extent that there's a legal retirement obligation identified, a company will look to estimate what that retirement obligation is. And that estimate will be based on what a third party would incur in terms of costs to perform that retirement obligation activity for the company. The company would then present value of those future retirement expenditures back to today's dollars and would recognize an obligation called a asset retirement obligation with an offsetting -- and that's it -- with an offsetting debit, an asset retirement cost.

Now, I think it's important to note that that asset retirement cost is not a separate asset of the company, but rather it's a part of the operating asset, the long-lifed asset which it's associated with. So in this case, it would be the coal plants. And FASB was very specific on this point. They viewed that the asset retirement obligation was integral to our prerequisite for -- for operating the long-lifed asset. It was not a separate asset, but it was part of the overall long-lifed asset.

And then what would happen is, is that asset retirement cost, the asset, would be amortized over the life of the operating asset. The obligation, which I mentioned, which is present valued, would be accreted into the future. Accretion expense would be incurred every year to increase the obligation as you came closer and closer to those retirement activities.

Both of those items would be reflected as expense, annual expense, a period charge within a company's financial statements.

Separately, what has to happen is then a company would if it was a rate-regulated entity, would make a determination as to whether or not those expenses are recoverable from ratepayers in the future. And standard there is, is it probable of recovery from ratepayers in the future? Not guaranteed, but probable, which is generally 75, 80 percent, in terms of a percentage.

If it's deemed probable, then it would result in the company recognizing a regulatory asset and reversing the expense that was recognized under the ARO accounting for that year. And so you would end up with a regulatory asset. That regulatory asset would only get reversed when those -- when that amount was actually recovered from ratepayers.

I'd like to -- I'm sorry, you were on mute. But maybe I just want to make one clarifying point. At the time a company estimates its ARO or its asset retirement obligation, that represents an estimate. An estimate of what a third party will incur to perform those retirement activities. Even if the company will perform them on its own, but it has to be in the eyes of a third party.

Separately, it's an estimate, and estimates can change over time based on changes in facts and circumstances, changes in technology. In addition, there can be multiple scenarios in terms of how retirement activities are performed. If that was the case, then the utility would apply a probabilistic model to come up with that asset retirement obligation.

But the key point there is, is that overall, this asset retirement obligation is an estimate. And to the extent that the estimate changes, it would be recognized in that period as a change in estimate.

Q. Okay. So it would be fairly typical for those estimates to change over time; is that correct?

A. Yes. Excuse me.

Q. That was a yes?

A. Yes. Yes.

Q. And you talked about when the initial retirement cost is established and its connection to the facilities, and you also -- you've heard testimony or the standard of used and useful.

Can you talk about how -- in creating or establishing that initial retirement cost, how that can relate to the idea of used and useful?

MR. GRANTMYRE: I object. I don't remember any cross examination on the terms used and useful. This is Bill Grantmyre.

MR. HESLIN: The questions -- the cross

examination by Mr. Grantmyre was about ARO accounting. I'm talking about a facet of ARO accounting, and in particular, the initial retirement costs. And so I'm asking a question that is very related to cost, it just wasn't -- the three words "used and useful" weren't included in your cross.

CHAIR MITCHELL: All right. Mr. Heslin, I'm going to overrule the objection. I'll allow the question to proceed, but please stick to redirect.

MR. HESLIN: Yes, Chair Mitchell.

THE WITNESS: So maybe going back to what I said earlier, that the FASB looked at that asset retirement cost as being integral to the operating asset, itself. In this case, the coal plant. The coal plant was deemed used and useful and was a recoverable cost for ratepayers.

The one point that I would like to highlight, and it was just mentioned in my testimony, that ASC 410 is typically excluded from ratemaking. The reason for that is because, in many cases, there hasn't been a cash outlay associated with the asset retirement obligation.

So in this case, although the asset -- asset retirement cost has been recognized, there hasn't been a cash outlay as yet related to the retirement obligation efforts.

And therefore, what we typically see, what I typically see across the country is that that asset retirement cost and obligation are excluded for purposes of rate base, and instead are recovered in the future as the company gets closer to its retirement activities or gets beyond its retirement activities.

Q. Thank you, Mr. Riley. And kind of following up on that, Mr. Grantmyre walked you through certain parts of your testimony where you state very clearly that you recognize the principle that accounting follows ratemaking. But I'd ask you to provide a little context for those statements in your testimony and why that applies here within the context of the coal ash expenses and costs that we're talking about.

A. Certainly. So it is a favorite phrase of ours in the utility world, and really what it's meant to say is that Commissions have a lot of latitude, obviously, in terms of setting rates. For purposes of financial reporting, what ASC 980 does, GAAP accounting, it recognizes the effects of how rates are established by a Commission. Not the other way around. The accounting comes after rates are determined.

And the consequences of that can be, as we talked about earlier, a deferral of expense, because that expense could be recovered in the future rather than as a -- in the period that it's incurred, it could be recovered in the future from ratepayers, and therefore the accounting would defer the expense. Similarly, if a company were to recover monies ahead of incurring a cost, as is in the case of cost of removal, for example, it could result in establishing an obligation, a regulatory liability is what we call it, to be carried on the books of the financial statements.

But it's an important point that, for financial reporting purposes, the Commission sets rates, and then for financial reporting purposes, you reflect the impact of those decisions in the financial statements of the Company.

Q. And I think you might have touched on it with that answer, but I just want to be clear. Mr. Grantmyre asked you to turn to page 21 in your testimony when he was going through the series of questions about certain statements about ASC 410 in your testimony. And on line 6 and 7 of page 21 of your prefiled rebuttal testimony or your rebuttal testimony, it states:

"However, ASC 410 acknowledges that many regulated entities recover asset retirement costs differently than how GAAP may recognize the related expense."

Do you have any further context or explanation for that statement, or have you covered that?

A. Just to clarify that point, what we see at utilities across the company -- the country, really what's getting at here is that, as I talked about earlier, over time, that asset retirement cost would be depreciated, and depreciation expense will be recognized. Similarly, the asset retirement obligation, because it has been present valued, must accrete over time up to the ultimate obligation that needs to be relieved. And so that accretion expense and that depreciation expense will be recognized in the financial statements of a company.

To the extent that it's probable that that depreciation expense and accretion expense will be -- is probable of being recovered from ratepayers in the future, then that expense would be deferred and the company would recognize a regulatory asset for those costs.

Q. And is that similar to what has happened here in this instance, or is it different?

A. It is similar. This is exactly how Duke has applied the accounting at DEC. And I would say it's -- in my experience working with utilities across the country, this is -- this is very consistent with what I see across the country.

Q. And in addition, Mr. Grantmyre, when he was walking you through the ratemaking statute, he highlighted the -- that GAAP and FERC were not contained or included in the texts of that statute. But to the extent that there are industry -- those are industry standards that apply to utilities such as DEC, do you have an opinion on whether deviations from those standards in different jurisdictions could have an impact on companies or the industry as a whole?

A. Well, I haven't -- I haven't read what was referred to, that -- the statute. It's not surprising to hear that it doesn't refer to GAAP or FERC, because, from my understanding and what I'm hearing, that relates to ratemaking and how rates would be established. Which is completely -- as I said before, it's completely separate from financial reporting purposes. Financial reporting would be applied after the ratemaking is determined.

Now, I point out that we've talked about deferral of expenses for future recovery. If for some reason that these costs were deemed not to be recoverable, then that would result in a charge by the Company for disallowed costs. So that's the flip side to what we're talking about, for financial reporting purposes.

Q. And you wouldn't be surprised to know that Rule 8-27, North Carolina Utilities Commission Rule 8-27 requires the FERC Uniform System of Accounts of utilities, but -- would you?

A. No, that would not surprise me.

Q. And then from an accounting perspective, is there a bright line rule that dictates whether an activity is always capitalized or always expensed, or is the end purpose of that activity what governs the accounting?

MR. GRANTMYRE: I would object. I don't remember asking any of these questions about what's capitalized and what's not.

CHAIR MITCHELL: All right. Mr. Heslin, can you tie this to cross examination of your witness?

MR. HESLIN: Once again, it's just the general accounting principles that are inherent in the ARO. There's obviously been testimony before this about the ARO, and those costs coming out of ARO as whether they were expenses or some other category, and so these are redirect related to that facet of the -- of the testimony.

CHAIR MITCHELL: All right. Mr. Heslin, I'm going to allow -- I'm going to overrule the objection. I'm going to allow the question to proceed, but I'm going to ask you one more time, let's stick to redirect here.

MR. HESLIN: Thank you, Chair.

THE WITNESS: To answer your question in the context of ARO accounting, I would say it is unique. If I go back to my initial statement, when a company makes an estimate of a legal retirement obligation, it records an asset retirement obligation and an associated asset retirement cost. Again, that's an asset. You say what is that asset comprised of? It's comprised of the estimate of future retirement activities associated with legally retiring that asset, whatever that means in that particular context.

And so it's retirement activities in this case that are getting capitalized on a present-value basis. So it's very unique as it relates to ASC 410 as compared to other GAAP that you might point to in terms of capitalization of property plant equipment versus recognition of period costs. ASC 410 is very specific in terms of how that asset retirement cost is built up.

Q. Thank you, Mr. Riley.

MR. HESLIN: Chair Mitchell, I have no further redirect at this time.

CHAIR MITCHELL: All right. Questions from Commissioners, beginning with Commissioner Brown-Bland.

COMMISSIONER BROWN-BLAND: I don't have any questions.

CHAIR MITCHELL: All right. Commissioner Gray?

COMMISSIONER GRAY: No questions.

CHAIR MITCHELL: Commissioner Clodfelter?

COMMISSIONER CLODFELTER: Nothing.

CHAIR MITCHELL: Okay.

Commissioner Duffley?

COMMISSIONER DUFFLEY: No questions.

CHAIR MITCHELL: Commissioner Hughes?

COMMISSIONER HUGHES: Yes.

EXAMINATION BY COMMISSIONER HUGHES:

Q. Just a clarification question. In your testimony you talk a lot about best practices or practices you've seen across the country. I realize there's a lot of unique things going on here. But I just wanted to get a better understanding of how what's being talked about in North Carolina relates to both the accounting standards and what you see in other jurisdictions. I think what the Public Staff is proposing in a lot of ways with this equitable sharing is not occurring through an accounting treatment, but it's occurring through a ratemaking treatment with the assignment of a rate of return.

And I just want to clarify that, that is what the Public Staff is -- has talked about by looking at a future net present value and coming up with some sort of net present value of option one versus option two. I'm not sure if you've looked at the economic analysis that the Public Staff is requiring, but that's what I see -- think they're requiring. That's what they're proposing, is option one versus option two, and they get to their equitable sharing by comparing option two to option one. But I think both of those options are economic analyses, they're not accounting treatment.

So I'm trying to understand, from an accountant's perspective, and an ARO accounting perspective, can what the Public Staff is proposing be done without involving any kind of changed accounting? In other words, if the rate of return is set at a ratemaking period, and that's known and that's moving forward, that all can be done within the confines of this ARO accounting standards; can it not? I know that was a long question. I'm happy to try and clarify it.

A. No, sir. I understand your question. Maybe I can try to respond, and then if I don't fully respond, you can follow up with a question.

I understand your point around an economic analysis. If I were to step back as just an accountant thinking about this situation, as I think about any sort of recovery of cost, recovery of an asset, what I have to ask myself is: Based on the accounting standards, is the Company receiving full recovery of its costs, and by the way, if it's actually been out-of-pocket cash, getting a return, an allowed return as well on those costs, or is it something less? If it's receiving something less than a full return, a full recovery of and on costs that it has expended, then that would be viewed as being a disallowance.

It can be an explicit disallowance or an implicit disallowance. And there are accounting standards that drive disallowances. So to the extent that a utility expends $1,000, for example, and is not allowed recovery on and of that $1,000, say the regulator determines that it will only allow recovery of $800 over a five-year period, or say the utility is only allowed recovery of $1,000 but over a five-year period, in both of those situations, an auditor would look at that and say there's been an explicit or an implicit disallowance of costs. And that disallowance would be recognized immediately, as opposed to over time.

So there are accounting consequences associated with -- call it an economic analysis that results in a sharing of costs. That sharing what the rate -- what the shareholder is called -- is absorbing, it's recognized immediately.

Q. So with that -- with that explanation, what do accountants use as the default rate of return for calculating the disallowance? Is that -- isn't that set at rate setting time, or is there some sort of standard that you use for the default?

A. It can depend on the situation, but in the case of a company using its general funds, in this case you would say for ash -- coal ash remediation, generally it would be the weighted average cost of capital.

Q. So that's what you would -- that's what you would use kind of as the default rate?

A. That's correct.

Q. Okay. And then if I can just understand -- just this is a basic question. When you were talking about -- a number of times I think I heard that you said that these ARO assets are very difficult to map over to physical assets. Is that true? I mean, if I had -- if there's an asset on the book that is actually a physical asset that I could go see versus an ARO asset, that if I follow the way those were treated, I would see a number of differences? I mean, the ARO asset gets on the books before the physical asset is even there before a dollar's even been spent; is that correct? But that wouldn't happen with the physical asset?

A. I apologize if I was unclear earlier. So you have the creation of an actual physical asset. Let's use the coal plant in this example. The coal plant is built, you have a physical asset. The Company has determined that there is a legal retirement obligation driven by CAMA, driven by CCR, and therefore it must recognize an asset retirement obligation and an associated asset retirement cost, an asset.

The FASB -- the Financial Accounting Standards Board does not look at that asset retirement cost as being some separate intangible asset. It's not a separate asset, but rather, that asset retirement cost is part of the coal facility, itself. It's part of that operating long-lived asset. And that asset retirement cost would be amortized over the life of that coal asset.

So depending on what asset retirement obligation you're talking about, you can have different asset retirement costs that are mapped to different assets that created that legal retirement obligation.

Q. But from a -- from that standpoint, if I'm looking at a coal plant, I'll see a lot of physical things made out of concrete and steel. They will be getting a rate of return on that asset being shown up. Then over here to the left I have to visualize a bunch of future trucks carting -- carting ash away, and that's this untangible asset. That part of the asset has a value but doesn't exist yet. There's not a truck moving forward.

Does that part of the asset -- is that earning a return in the same year that the physical parts of the asset are earning a return?

A. That's a good question, and that gets into my point around the cash. At the time that asset retirement cost is recognized, the utility is not out-of-pocket cash. In your words, the trucks haven't started coming in to remove those assets. And so as a result, that asset retirement cost and obligation for ratemaking purposes are typically excluded from rate base. And if you follow Duke's accounting, what happens is, bear with me, that asset retirement cost is depreciated, that asset retirement obligation is accreted, expense is recognized on an annual basis. Duke takes the position that it's probable that those expenses are recoverable in the future from ratepayers, so it reverses that expense and records a regulatory asset. Now, at that point, it's still not out-of-pocket cash, so they record the regulatory asset, but they do not earn a return on that regulatory asset.

At a future point in time when they start expending monies, now cash is actually starting to flow, they reverse that regulatory asset and record a regulatory asset, I think they call it a spent regulatory asset, to designate amounts recoverable from ratepayers for which they are out of pocket cash. They have used shareholder funds, and as a result should earn a return on that spent regulatory asset. I hope that answers your question.

Q. I have it now. And you wrote some of that in your testimony and you answered that before, I just needed to hear it three times. Thank you. No further questions.

A. Thank you.

CHAIR MITCHELL: All right. Commissioner McKissick?

COMMISSIONER McKISSICK: Just one or two brief questions.

EXAMINATION BY COMMISSIONER McKISSICK:

Q. Mr. Riley, with Pricewaterhouse, you

obviously provide similar comparable services as to what you're doing in this case to utilities across the country; is that correct?

A. That is correct.

Q. So let me ask you this, because we've been focused so much on what Duke is doing or the way they've handled things. In other jurisdictions that had the, you know, used coal as the way of generating electricity, they had the coal ash ponds or impoundments, in those other jurisdictions that you are familiar with, are they wrestling with these same types of issues at this time in terms of accounting in the way they're establishing things?

A. In my opinion, no. No.

Q. They're not in other places? What did they do in other jurisdictions to handle things differently in terms of potentially treating the coal generation facilities in a way to know that when they came to their end and they had these impoundments to deal with, to go ahead and put aside reserves for addressing it?

A. Generally speaking, it's how I just described it a moment ago where -- where, generally around the time that CCR was issued, those asset retirement obligations and related asset retirement costs were recognized, they followed asset retirement obligation accounting, depreciating and accreting the asset liability, deferring the expense. And then regulators in a particular jurisdiction, really in the context of setting rates for that jurisdiction, had to decide at what point they allow recovery of those expenses, over what period of time.

Q. Thank you. I don't have any further questions.

CHAIR MITCHELL: Mr. Riley, I have one question for you.

EXAMINATION BY CHAIR MITCHELL:

Q. In response to questions from Commissioner Hughes, you indicated that, if there is a disallowance, whether it be implicit or explicit, that disallowance is recognized immediately and not over time; did I understand your testimony correctly?

A. That's correct.

Q. Okay. And so can you then sort of -- so then what happens? If the disallowance is recognized immediately, what is the significance to the Company? Help me understand sort of the rest of the situation.

A. Sure. Let me go back to my example, which was say there's a $1,000 asset and a commission chooses to allow only recovery of $800 of that asset over a five-year period. So that translates into -- or we'll make it a four-year period, make the math easy. So instead of recovering $250 a year, they're going to recover $200 a year.

What GAAP -- what I'm getting at related to the disallowance and the immediate recognition of that loss is that GAAP does not want to defer that loss. It's a known loss. You're going to not recover $200. So why defer that loss and recognize it evenly over a four-year period? It needs to be recognized today.

Now, the impact of that would be a charge to the financial statements of the utility, and it would impact the Company's net income in that period. Now, I would also say, just qualitatively thinking about it as a person that works in the utilities sector, from the financial side, to the extent that there's a disallowance, that raises concerns related to regulatory uncertainty, and that creates concerns around credit and other potential issues associated with the Company that could obviously impact the Company's cost of capital.

Q. All right. Thank you, Mr. Riley.

CHAIR MITCHELL: All right. Questions

on Commissioners' questions, beginning with the Public Staff?

MR. GRANTMYRE: Yes. This is Bill Grantmyre again, on Commissioner Hughes' questions.

EXAMINATION BY MR. GRANTMYRE:

Q. Has DEC in this case proposed to include in rate base any portion of the balance of the asset retirement cost asset?

A. I don't believe so, sir, but I would -- I would say that that's more of a question for the Company to confirm.

Q. Are you aware that DEC is trying to include in rate base only a portion of the deferral of depreciation and accretion expense?

A. I think that they're looking to include the spent regulatory asset that I mentioned earlier.

Q. Thank you, that's all I have.

CHAIR MITCHELL: All right. At this point we are going to --

MR. HESLIN: Chair Mitchell, I have one question --

CHAIR MITCHELL: Mr. Heslin, we --

MR. HESLIN: Oh, you can -- I'm sorry.

CHAIR MITCHELL: Did I -- let's see. We're going to go ahead and take our break now for lunch. We'll go off the record. We're going to go back on at -- we'll be back on at 1:30.

(The hearing was adjourned at 12:29 p.m. and set to reconvene at 1:30 p.m. on Tuesday, September 15, 2020.)

CERTIFICATE OF REPORTER

STATE OF NORTH CAROLINA)
COUNTY OF WAKE)

I, Joann Bunze, RPR, the officer before whom the foregoing hearing was taken, do hereby certify that the witnesses whose testimony appear in the foregoing hearing were duly affirmed; that the testimony of said witnesses were taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

This the 17th day of September, 2020.

JOANN BUNZE, RPR
Notary Public #200707300112