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Clerk's Office
N.C. Utilities Commission

March 18, 2009

Ms. Renné C. Vance, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4325

RE: Docket No. E-7, Sub 856

Dear Ms. Vance:

Enclosed for filing are the original and thirty (30) copies of Duke Energy Carolinas, LLC's Reply Brief in the above referenced docket.

Sincerely,

Robert W. Kaylor

Robert W. Kaylor

Enclosures

cc: Parties of Record

clerk
w/o conf.:
AG
3 Legal
3 Accts
2 Econ
3 Elec.
w/conf:
7 Comm
Bennink
Kirby
Watson
Hoover
Kite
Hilburn
Sessoms
Ericson
Jones

PUBLIC VERSION

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-7, SUB 856

Application of Duke Energy Carolinas, LLC For Approval of Solar Photovoltaic Distributed Generation Program and for Approval of Proposed Method of Recovery of Associated Costs	)))))	**DUKE ENERGY CAROLINAS, LLC'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR RECONSIDERATION**

INTRODUCTION

On December 31, 2008, this Commission issued an *Order Granting Certificate of Public Convenience and Necessity with Conditions* (the "Order") in this docket in connection with the application of Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or the "Company") for approval of its Solar Photovoltaic Distributed Generation Program ("Program"). On January 29, 2009, the Company filed a Motion for Reconsideration of the Order ("Motion"). Pursuant to the Commission's *Order Allowing Briefs on Motion for Reconsideration and Scheduling Oral Argument* ("Reconsideration Order") and subsequent *Order Granting Motion to Reschedule* in this docket, Duke Energy Carolinas submits this Reply Brief in Support of its Motion and in response to the parties' initial briefs.

ARGUMENT

I. Public Staff's Markup of the Order is Well-Meaning, But Will Not Resolve the Issue Without Assurance that Implementing the Program is Prudent.

In its Order, the Commission has identified the cost of Duke Energy Carolinas complying with the tax normalization rules as a distinct Program cost element. It has explicitly excluded that cost from recovery in the Renewable Energy and Energy

Efficiency Portfolio Standard ("REPS") rider and, thereby, imposed on the Company the necessity to affirmatively prove that this cost is reasonable and prudent in a subsequent base rate proceeding. In this regard, the Order states, "If the federal tax code treats self-generation of solar energy by a public utility less favorably than the purchase of solar energy from a third party, then prudence points in the direction of not self-generating, but instead purchasing the needed solar energy." Order at 15. Reading this statement, the Company arrived at the inescapable conclusion that, should it proceed with the Program, there is at least a possibility, and, perhaps, a likelihood, that it will not be granted recovery of some or all of the cost of normalization compliance. The Company believes that the failure to recover any part of that cost would constitute a violation of the tax normalization rules and subject it (and its customers) to the loss of hundreds of millions of dollars of tax credits. The Public Staff apparently does not disagree with this assessment.[1]

In its Initial Brief, the Public Staff contends that some tinkering with the language of the Order while not changing any of its substance will suffice to eliminate the risk of a normalization violation. The Company wishes it were that easy. It is not.

The investment tax credit ("ITC" or "Credit") normalization rules require that the credit produced by an asset reduce cost of service no more rapidly than ratably over the life of that asset. Thus, for example, if a $1,000 solar facility upon which a utility can claim a $300 Credit is assigned a 30-year regulatory life, the tax expense element of cost of service can be reduced by no more than $10 per year. Assume the present value of the 30 years of annual tax expense reductions is $130. This makes compliance with the

[1] Nevertheless, the Public Staff accuses the Company of an "overly expansive" interpretation of the normalization rules, an accusation that will be addressed hereinafter.

normalization rules about $170 more expensive than if the company could pass through the entire benefit of the credit to customers immediately. Disallowing all of this $170 places customers in precisely the same economic position they would have occupied had the Credit been flowed through. This obviously would violate the normalization rules. Moreover, disallowing any portion of the $170 places customers in an economic position that, while it may not be the economic equivalent of complete flow through, certainly increases the benefits of the Credit to them above the $130 ceiling permitted by the normalization rules. Consequently, the disallowance of any portion of the cost associated with complying with the tax normalization rules will constitute a violation of those rules because it will pass to customers a level of benefit that exceeds the ratable portion permitted under those rules. *See* Duke Energy Carolinas Initial Brief at 8-12 (discussing how any violation – no matter how small – of these rules results in the incurring of full penalties).

A critical factor in evaluating the Public Staff's proposal ("Proposal") is that the normalization rules recognize both direct and indirect violations. Regulations section 1.46-6(b) states:

> *(4) Indirect reductions to cost of service or rate base.*
>
> > (iii) ***A second type of indirect reduction is any ratemaking decision intended to achieve an effect similar to a direct reduction to cost of service or rate base. In determining whether a ratemaking decision is intended to achieve this effect, consideration is given to all the relevant facts and circumstances of each case, including, but not limited to—***
> >
> > > ***(A) The record of the proceeding,***
> > >
> > > ***(B) The regulatory body's orders or opinions (including any dissenting views), and***

> ***(C) The anticipated effect of the ratemaking decision on the company's revenues in comparison to a direct reduction to cost of service or rate base by reason of the investment tax credits available to the regulated company.*** (Emphasis added).

Included in the record of this proceeding will, of course, be all of the written testimony as well as the briefs of all parties – including that of the Public Staff. These documents, the Order, whatever final order this Commission issues, as well as all other material of record will provide the factual context within which the Internal Revenue Service ("IRS") may consider whether or not what this Commission ultimately does constitutes a direct or indirect violation of the normalization rules.

With this relevant background in mind, let us turn to the Proposal. The Public Staff's strategy appears to be as follows:

> Because the disallowance of normalization compliance costs will violate the normalization rules, the Commission should re-label those costs as something other than normalization compliance costs. Once that is done the re-labeled costs can be disallowed with impunity.

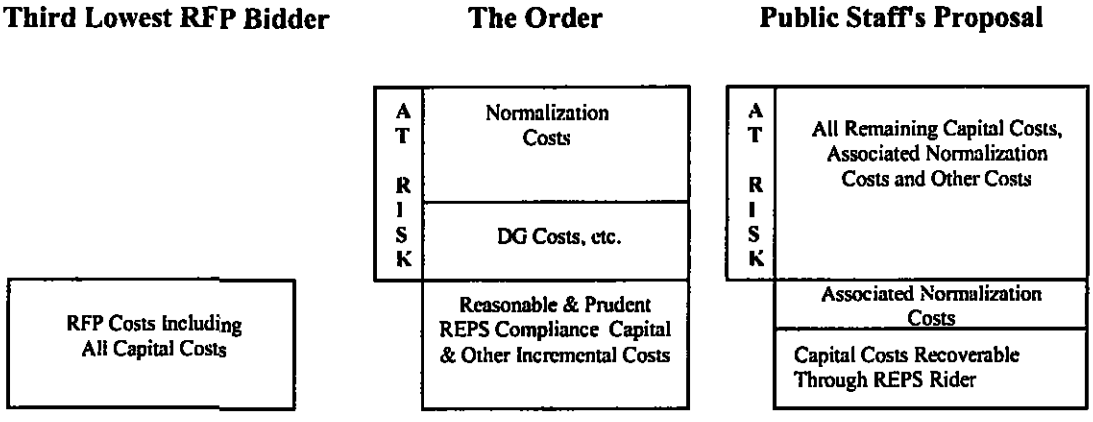
This strategy hinges on Public Staff's understanding of what transpired in this Commission's decision in Carolina Power & Light Co., Docket No. E-2, Subs 537 and 333. In that case, a portion of the capital costs of the Harris Nuclear Plant was disallowed – without a normalization incident. In general, there is nothing in the normalization rules that prevents a regulator from disallowing any cost – other than tax benefits associated with investment tax credits and accelerated depreciation. The Commission can disallow whatever plant costs it deems appropriate subject only to state law and Constitutional limitations.

Although the normalization rules play no direct part in that determination, these rules do play a role once the disallowance decision is made. Under these rules, the tax benefit of any cost attributable to a depreciable public utility asset must be allocated to the group (customer or shareholders) who bears that cost. For example, if $1 million of public utility solar plant costs are disallowed and if that $1 million of plant costs generated $300,000 of credits, then customers cannot be benefited by any portion of the $300,000 of credits. Neither can the benefits of tax depreciation produced by the disallowed $1 million of costs be allocated to customers. Both sets of tax benefits must be allocated to shareholders – the ones who bear the cost of the disallowance.

With regard to the Harris Nuclear Plant situation, so long as the ITC and accelerated depreciation associated with the disallowed portion of the plant were not reflected in ratemaking, then the normalization rules presumably were satisfied. Based on the results of the CP&L situation, the Public Staff has apparently concluded that re-classifying normalization compliance costs as utility solar asset costs represents a way to convert non-disallowable costs into disallowable ones.

In its Proposal, the Public Staff proposes two steps that, it claims, will insure that a violation of the normalization rules is avoided. The first step is to extract or alter certain language in the Order. In this regard, Public Staff states, "By simply revising the December 31 Order to remove the troublesome language drawn from the Public Staff's proposed order, the Commission can amply protect Duke against the risk of tax credit forfeitures." Public Staff Initial Brief at 6. The second step is to divide the fixed assets generating the credits into REPS rider and base rate recovery portions. As the Company understands the proposal, the Public Staff would start with the third lowest solar bid and

back into the quantity of Program assets that could be supported by that pricing, taking into account the normalization costs associated with that quantity of assets. The remaining assets – and their associated normalization compliance costs - would be allocated to the base rate portion. The Public Staff's "recasting" process can be graphically depicted as follows:



The Public Staff's purpose appears to be to allow the Commission to disallow base rate-associated ("at risk") plant costs without violating the normalization rules based on the premise that what are disallowed are not normalization compliance costs.

A comparison of the depiction of the Public Staff's Proposal to that of the Order highlights two of the Proposal's particularly important features. First, to make room within the REPS rider for the associated normalization costs, some of the costs of the physical assets needed to produce the solar power are kicked out of the REPS rider pool into the "at risk" pool. These costs must thereby be legally declassified as "incremental costs" – that is, reasonable and prudent costs incurred by the Company to comply with the requirement of the REPS statute. There has been no testimony, never mind a finding of fact, in this proceeding to support such treatment of these costs.

But the most critical feature the graphic comparison discloses is that the Proposal changes absolutely nothing economically. The identical quantity of costs is recoverable through the REPS rider. The identical quantity of costs continues to be at risk. Both customers and the Company remain in precisely the same positions relative to each other. The issue is, therefore, the extent to which the Proposal merely clothes a violative disallowance of normalization compliance costs in the disguise of a permissible plant disallowance – an indirect normalization violation. Again, the Public Staff proposes no economic alteration whatsoever. And the CP&L decision provides no comfort.

The record in that proceeding did not involve the kind of sleight-of-hand that is proposed in this proceeding. The disallowance in that proceeding was a pure, unadulterated plant disallowance from start to finish. Obviously, that is not the situation in which we find ourselves here. The Company believes that changing the language of a single document where the change carries with it absolutely no real-world consequences represents much too thin a veil. The context (the testimony, the Order, the briefs, etc.) is, and will remain, simply too rich in contrary indicators for this to be an effective solution. Thus, the Company believes it highly unlikely that the Proposal will insulate the Company and its customers from a damaging tax outcome.

In its Initial Brief, the Company offered two alternatives – (1) to include normalization compliance costs as "incremental costs" and (2) to provide assurance of recovery of all Program costs subject to the prudence of the Company's execution. In either case, the normalization compliance costs would be recovered and, thereby, preclude a violation of the normalization rules. It is the Company's strong belief that, in

light of the nature of the record of this proceeding to date, some affirmative economic act is required. Either of the two alternatives offered above would fit the bill.

The Public Staff accuses the Company of "interpreting the IRS normalization regulations in an overly expansive manner." Public Staff Initial Brief at 6. This charge appears to be aimed at the comprehensive nature of the solutions the Company proposes. The Company makes no apologies – its solutions clearly solve the problem. In place of a solution of this type, the Public Staff offers a Proposal that is transparent, even flimsy. It is abundantly clear to the Company that they have insufficient respect for these rules.

While either of the Company's two proposals would be effective, in light of the Public Staff's obvious desire to do less rather than more, the Company has developed a third alternative that is less comprehensive, less "intrusive," but which should also neutralize any normalization problem. The Company proposes to proceed with the Public Staff's suggested language "clean up" (their first step). However, instead of merely changing the names of costs, the Company proposes to introduce into the revised, "clean" order both a finding of fact and an ordering paragraph to the effect that normalization compliance costs necessary to conform to both the ITC and the depreciation normalization rules are reasonable and prudent and, therefore, fully recoverable.

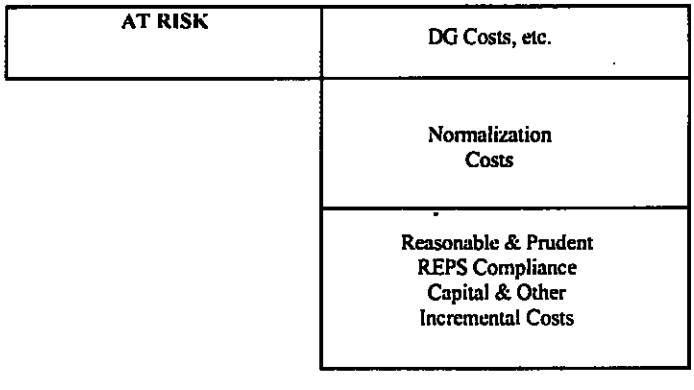
At the bottom of page 16 of the Order, the Commission stated that, "Except in very unusual circumstances, it would be inappropriate to disallow costs in a CPCN proceeding." The Company submits that, in light of the nature of the finding requested and under the unusual circumstances present here, the requested finding of prudence is entirely appropriate in this proceeding.

The prudence of normalization compliance by a utility is self-evident. This can be illustrated with two simple examples. Assume that a non-regulated entity is entitled to a tax credit equal to 10% of the cost of an asset but that a regulated utility is entitled to a tax credit equal to only 7% of the asset's cost. Can the utility's non-entitlement to the extra 3% credit ever rationally be deemed unreasonable or imprudent? A 7% credit is what the tax law provides. The utility has no control whatsoever over this. By the same token, if a competing solar provider was a tax-exempt entity, could the Company's payment of taxes rationally be deemed imprudent or unreasonable?

The Company believes not. Yet the implication of the Order is that, in this case, something analogous, compliance with the normalization rules, might be. No party to this proceeding can honestly believe that it is in the best interests of any stakeholder for the Company to violate either set of the normalization rules. If this is so, the inherent prudence of the costs of normalization compliance becomes a foregone conclusion. No testimony should be required to arrive at such a finding of fact.

The graphic depiction of the consequences of such a revised order is as follows:

Duke Energy Carolinas'
Third Alternative Proposal



Acceptance of this third alternative would serve to avoid a normalization violation and correct the Order's counter-intuitive implication that compliance with the tax law might not be reasonable and prudent. The Company has attached, as Exhibit A, a copy of the Order annotated to show what it believes are the appropriate alterations.

II. The Company's Response To the Parties' Briefs.

A. The Public Staff's Statement That it is Unlikely That Any of the RFP Bids Would Ever Be as High as the Program Costs Is Conjecture.

In its Initial Brief, the Public Staff takes issue with the Company reiterating and "placing additional emphasis on" an argument that it made during the hearing and through its briefs, specifically, that the Company is "more experienced and reliable than third-party suppliers, and consequently the risk of default is reduced when Duke constructs its own generating facilities." Public Staff Initial Brief at 7-8. Additionally, it argues that while Duke Energy Carolinas certainly is experienced in conventional generation, it has no experience in constructing solar facilities, and that even in conventional generation projects, any utility is subject to cost overruns and delays. *Id.* at 8. This comparison is misplaced for a number of reasons.

First, Duke Energy Carolinas intends to enter into agreements with experienced solar energy firms to execute the Program. As discussed in the testimony of Company witness Smith, as a general rule, the Company will look to contract with suppliers to provide those facilities, much in the way that it has contracted with Sun Edison for centralized solar generation. The Company's expertise more naturally lies in procurement, management, and oversight of construction projects, and this expertise is directly applicable to this Program.

Secondly, the Company's arguments regarding experience and reliability have nothing to do with the actual construction – bricks and mortar – of the facilities. The issues, as spelled out in Ms. Johns' affidavit, have to do with **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Those are issues regarding which Duke Energy Carolinas generally has significant expertise and likely has an advantage over a non-utility renewable supplier given that the renewable market is a less mature and evolving industry. Lastly – and possibly most importantly – non-utility providers do not operate under the statutory obligation to provide adequate, reliable, and cost effective electricity to its customers that governs Duke Energy Carolinas' regulated existence. The purchased power provider answers to a contract. The Company answers to the Commission. This is a necessarily higher standard that the Company must meet. As a result, the Public Staff's suggestion that utilities should be foreclosed from owning and operating solar generation due to the impact of the tax normalization requirements is too extreme. Public Staff Proposed Order at 17. Rather, the Company's proposed mix of utility-owned generation, purchased power agreements, and REC purchases is a more prudent approach.

What's more, during the hearing, the Company entered facts into evidence that plainly articulated that RFP bids are far from stable and many times are less than the costs paid by the Company via the terms of the final, later agreed-upon contract. T. Vol. 1 at 147-48; Vol. 2 at 85-86. The Public Staff argues in its Initial Brief that "even if one of the three lowest bidders were to raise its price during the course of contract

negotiations, it would be highly unlikely to ask for a price as high as Duke's" (Public Staff Initial Brief at 8), yet provides no basis for coming to such a conclusion, and presented no witness at the hearing to lay the groundwork for such a position. In fact, the Public Staff has produced not a single witness who was able to subvert the credibility of Duke Energy Carolinas' witnesses (Company Witnesses Smith and McManeus) on this point. Additionally, the sworn assertions submitted by the Company via Ms. Johns' affidavit regarding the tenuousness of using RFP bid prices to represent anything more than what it is – a bid, not a contract price – remain uncontroverted by any of the intervenors.

These facts speak for themselves. Comparing the bids to one another and to the Company's own cost estimate is one thing. Setting a hard and fast maximum recovery cap based on subjective measures – especially when the qualitative nature of the Company's assertions of the benefits of the Program is used as justification for declining to provide assurance of cost recovery – is a different problem. The Public Staff's conclusory statements are not based on any apparent fact, and should be disregarded by the Commission.

B. The Attorney General's Brief Misstates The Commission's Prior Ruling in Docket No. E-7, Sub 819.

The Attorney General's argument ignores the facts of this case, as well as the intent of the Commission's *Order Issuing Declaratory Ruling*, in Docket No. E-7, Sub 819 (March 20, 2007) ("Declaratory Order").

The Attorney General's argument that the Commission, in Docket No. E-7, Sub 819, "reaffirmed the futility of attempting to issue a declaratory ruling on future activities

and costs when Duke requested assurance of cost recovery for activities involved in developing a nuclear service" is a misstatement of the Commission's intent and resolution of the issue in that docket. Contrary to the Attorney General's characterization, the Commission, having concluded that it possessed the legal authority to make a declaratory ruling in that proceeding, "conclud[ed] that it is in the public interest for the Commission to issue a declaratory ruling which gives Duke a general assurance that its activities in assessing the development of the proposed Lee Nuclear Station through December 31, 2007, are appropriate activities." Declaratory Order at 22.

Without fully repeating the arguments that the Company made in support of this reasoning in its Motion for Reconsideration and its Initial Brief in Support of its Motion for Reconsideration, the Company reiterates that the "general assurance" that the Commission gave the Company in the Lee Nuclear docket is the same general assurance that the Company seeks – and believes is appropriate – in this case. Moreover, this case is different from the usual application for a certificate of public convenience and necessity ("CPCN"). Typically, by granting a utility a CPCN, the Commission concludes that the utility has demonstrated a need for generation, the applicant's proposed generating facility is appropriate to meet that need, and that the utility's cost estimate is reasonable. Historically, as long as the utility subsequently demonstrates that its execution of the construction for the approved facility was reasonable and prudent, the utility has a reasonable assurance that it will recover its costs.

This case, however, does not present the typical fact pattern, and the Commission, in granting Duke Energy Carolinas the CPCN for the Program, did not issue a typical CPCN order. Rather, in granting the CPCN, the Commission *itself* raised questions of

whether it is appropriate for the Company to move forward with the Program. The Commission's Order is riddled with suggestions that the Commission would rather the Company purchase solar-generated power to fulfill its REPS requirements instead of attempting to achieve compliance through the Program. As noted in Section I above, the most obvious example of this suggestion of imprudence is the statement that "[i]f the federal tax code treats self-generation of solar energy by a public utility less favorably than the purchase of solar energy from a third party, then prudence points in the direction of not self-generating, but instead purchasing the needed solar energy." Order at 15.

As a result, the Company does not feel comfortable moving forward with the Program pursuant to the current CPCN because even if the costs of the Program ultimately end up being on point with the initial estimate, there appears to be no reasonable certainty – as would normally exist with a typical CPCN – that the Commission would approve the recovery of the costs in excess of the third-placed bid. This concern, coupled with the risks raised by the tax normalization issue demonstrate the need for assurance from the Commission that it does indeed find implementation of the Program to be prudent.

Furthermore, the Attorney General's suggestion that instead of granting the relief the Company has requested, Duke Energy Carolinas should file annual proceedings under N.C. Gen. Stat. 62-110.1(f) and (f1) ignores two critical facts. First, the Company plans to spend the full $50 million Program costs in a two-year period. T. Vol. 1 at 56. Thus an annual review after a significant portion of the total Program costs are spent, would not remedy the risk of violation of the tax normalization rules. Second, as explained in the Company's Initial Brief and above, even a partial failure to comply with the ITC

normalization rules constitutes a total failure to comply. The full measure of the penalties becomes applicable, that is, with respect to all previously-claimed credits and to all property otherwise eligible for credit. In this way, a very minor infraction can attract a disproportionately major adverse consequence. Duke Energy Carolinas Initial Brief at pp. 8-12. Therefore, the Attorney General's alternative proposal simply will not suffice.

C. The Solar Alliance's Request for a Customer-Generator Standard Renewable Energy Certificate ("REC") Purchase Offer and a Cost/Benefit Analysis were Already Considered and Rejected by This Commission.

During the evidentiary hearing, Solar Alliance Witness Carrie Hitt testified that while she was "in agreement with Duke that the program will enable Duke to learn more about solar PV," and that she "supported Duke's proposal to collect information about the economic and physical impacts" of the Program, she "recommended that Duke be required to collect comparable information from a sampling of installations that it does not own and to make all of this information available to the public through the Commission." Order at 9. Similarly, in its initial brief regarding Duke Energy Carolinas' Motion, the Solar Alliance recommended a plan for Duke Energy Carolinas to develop a detailed research plan regarding the benefits of targeted distributed generation. Solar Alliance Initial Brief at 4. In addition, in its Initial Brief, the Solar Alliance essentially repeats its request from the hearing – that the Program incorporate a requirement that the Company purchase RECs from customer-generators (T. Vol. 2 at 138-39). It again proposes that the Company be required to reduce the Program by another 50% via a half utility-owned solar/half customer-owned (e.g., REC purchases from customer-generators) concept. *Id.* at 3-4.

The Company genuinely appreciates the Solar Alliance's agreement on the unique benefits of solar distributed generation. The Commission, however, already has determined in its Solar Order that a detailed research study is unnecessary, stating,

> The Commission is not persuaded that Duke should be required to make arrangements with other owners of solar PV facilities to collect data comparable to the data it gathers with respect to its own facilities. This could potentially be a useful undertaking, however, and Duke is encouraged to collect such data if it chooses to do so. The Commission notes that the data gathered by Duke will be subject to discovery in future proceedings, particularly integrated resource planning proceedings; consequently, there is no need to require Duke to submit the data formally to the Commission in periodic reports.

Solar Order at 10. Moreover, the Solar Alliance continues to ignore the rule-making proceeding to implement Senate Bill 3 that resulted in the Commission rejecting a mandatory REC purchase obligation. The Solar Alliance was a party to that proceeding. Nevertheless, it yet again repeats its mandatory REC purchase request in its Initial Brief, despite the fact that the Commission already declined via the Order to require Duke Energy Carolinas to incorporate customer-owned generation via mandatory REC purchases into the Program. *Order* at 6, 19 (Finding of Fact 19). Ultimately, the Solar Alliance makes the same arguments in its Initial Brief regarding both a detailed research study and a revision of the Program to include mandatory REC purchases as it made during the hearing, and they should be rejected now as they were by the Commission in its Order.

Additionally, the Solar Alliance's arguments for a research study and standard REC purchase offer go beyond the scope of the issues that are to be addressed by the parties' briefs pursuant to the Commission's Reconsideration Order. The terms of the Reconsideration Order explicitly state that the "Presiding Commissioner finds good cause

to allow the parties the opportunity to file initial and reply briefs with regard to the *issues raised in Duke's Motion.*" Reconsideration Order, at 1 (emphasis added). The issues raised in Duke Energy Carolinas' motion pertain to (1) the risk of violation of the tax normalization rules that the Company now faces as a result of the Solar Order, (2) the arbitrary and capricious nature of the cap limiting the Company's cost recovery to that of the price of the third place bid from the Company's 2007 renewable RFP, and (3) and the evidentiary basis that support reconsideration of the imposition of this cap on the Company's cost recovery. To the extent that the Solar Alliance's brief addresses issues other than these – as it does with its second request to require Duke Energy Carolinas to modify its Program structure and conduct a research study – the Commission should reject those arguments.

D. NCSEA's Comparisons To Other Jurisdictions Are Off Base.

NCSEA also points to Progress Energy Carolinas, Inc. ("Progress") as well as utilities in other states (Arizona, Nevada, Colorado), as examples of utilities who have used REC purchases to comply with their respective renewable portfolio standard statutes. NCSEA Initial Brief at 7-9. NCSEA fails to mention, however, that Progress likely will hit the REPS cost caps long before it meets the higher compliance requirements in future years. *See* John Murawski, *Energy Targets Out of Reach: Utility Says Clean Electricity Will Cost Far Too Much*, Raleigh News and Observer, March 10, 2009. Additionally, the Company has evaluated each of the regulatory frameworks in

Arizona, Colorado, and New Mexico when developing its REC purchase program, and each are materially different from the REPS framework under North Carolina law.[2]

Lastly, NCSEA's statement that Duke Energy Carolinas' "North Carolina RFP remains unchanged" is, at minimum, a mischaracterization, and, at its worst, nonsensical. The Company has no reason to change an RFP document for an RFP *which is no longer ongoing*. Furthermore, despite the absence of a current renewable RFP, the Company actively encourages suppliers to submit proposals (including REC-only proposals) to the Company. *See* http://www.duke-energy.com/suppliers/carolinas-rfp.asp (stating, "Currently, Duke Energy Carolinas does not have an active renewable energy RFP. We welcome 'unsolicited' renewable energy proposals in the absence of an active renewable energy RFP. Duke Energy Carolinas continues to diversify the mix of fuels it uses to generate electricity for its customers by making significant investments in renewable energy projects."). Accordingly, NCSEA's arguments regarding the RPS standards of other jurisdictions are misleading and should be disregarded by the Commission.

E. The Public Staff's Suggestion that Duke Energy Carolinas' Request to Delay its 2010 REPS Solar Requirement is Premature is Puzzling.

Contrary to the Public Staff's assertion, the Company cannot wait until after the June 2011 hearing on its REPS rider to determine its course of action regarding whether

[2] Arizona's Renewable Energy Standard ("RPS"), for example, has a specific set aside for distributed generation. Initially, utilities must ensure that five percent of their renewable generation is derived from distributed renewable resources, and after 2011, that number jumps to 30%. *See* http://www.azcc.gov/divisions/administration/news/pr02-28-06.asp; *see also Opinion and Order*, Decision No. 69127 in Docket No. RE-00000C-05-0030 (In the Matter of the Proposed Rulemaking for the Renewable Energy Standard and Tariff Rules) (Nov. 14, 2006) at 87 (also at http://www.azcc.gov/divisions/utilities/electric/res.pdf). Additionally, Colorado's RPS has a four percent solar set aside that utilities must comply with by the year 2020, a requirement that is twenty times the size of the 0.2% requirement that North Carolina utilities must comply with by 2021. *See* http://www.pewclimate.org/what_s_being_done/in_the_states/rps.cfm.

to request a waiver of the 2010 REPS solar set aside requirements. Indeed, Rule R8-67(c)(5) provides that parties seeking a waiver of the REPS requirements must do so prior to the compliance deadline: "Retroactive modification or delay of the provisions of G.S. 62-133.8(b), (c), (d), (e) or (f) shall not be permitted." Rule R8-67(c)(5). Given the time it has taken to address the unintended tax normalization issue, even if the Motion results in a outcome that permits the Company to move forward with the Program, it may still be difficult to implement the Program quickly enough in order to fully comply with the 2010 REPS solar set aside requirements.

Ultimately, it is disingenuous for the Public Staff to suggest the Company should just gamble and take a chance that the Commission will excuse non-compliance. Non-compliance – versus an exemption – with the 2010 REPS solar set aside requirement is not an option that Duke Energy Carolinas voluntarily would consider, and that is why the Company has asked for such alternative relief should the Commission decline the Company's relief requested in its Motion for Reconsideration.

CONCLUSION

Duke Energy Carolinas respectfully repeats its request that the Commission withdraw the Order in its entirety and issue a new order consistent with one of the two alternative forms of relief requested by the Company in its Initial Brief (i.e., permit all Program costs to be recovered through the REPS rider or provide assurance that the Program costs will be recovered subject to the effectiveness of the Company's execution). However, should the Commission decline to adopt either of these forms of relief, the Company requests that the Commission accept the Company's alternative to the Public Staff's proposal and reissue the Order with its suggested language modifications

including a finding that compliance with the normalization rules is reasonable and prudent, as this would serve to avoid a normalization violation and correct the Order's unintended implication that compliance with the tax law might not be reasonable and prudent.

Respectfully submitted this 18th day of March, 2009.

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ATTORNEYS FOR DUKE ENERGY CAROLINAS, LLC

CERTIFICATE OF SERVICE

I certify that a copy of Duke Energy Carolinas, LLC's Reply Brief in Docket No. E-7, Sub 856, has been served by electronic mail (e-mail), hand delivery or by depositing a copy in the United States Mail, first class postage prepaid, properly addressed to parties of record.

This the 18th day of March, 2009.

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(919) 828-5250
NC State Bar No. 6237

EXHIBIT A

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 856

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Application of Duke Energy Carolinas, LLC, for Approval of a Solar Photovoltaic Distributed Generation Program and for Approval of the Proposed Method of Recovery of Associated Costs	)))))	PROPOSED REVISED ORDER GRANTING CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY WITH CONDITIONS

HEARD: Thursday, October 23, 2008, at 9:00 a.m., in Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina

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

APPEARANCES:

For Duke Energy Carolinas, LLC:

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For Wal-Mart Stores East, LP, and Sam's East, Inc.:

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For Southern Alliance for Clean Energy:

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For North Carolina Sustainable Energy Association:

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For the Using and Consuming Public:

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BY THE COMMISSION: On June 6, 2008, Duke Energy Carolinas, LLC (Duke), filed an application for a blanket Certificate of Public Convenience and Necessity (CPCN) authorizing construction over a two-year period of up to 20 megawatts (MW) direct current (DC) of solar photovoltaic (PV) generation and for approval of its proposed method of cost recovery. The facilities will be located within Duke's North Carolina service territory and will include both roof-mounted and ground-mounted facilities installed on the property of Duke's customers and on property owned by Duke. Duke will own all the facilities under the program, and the facilities will be interconnected directly to the power grid at the distribution or transmission level.

The scale of the program provides for multiple types of installations in multiple locations. Eighty to ninety percent (80-90%) of the proposed installed capacity will consist of large-scale installations such as ground-mounted facilities and rooftop installations on large commercial or industrial buildings, with individual facilities in this category ranging from 500 kilowatts (kW) to 3 MW. Up to 10% of the proposed installed capacity will consist of medium-scale rooftop facilities, with individual facilities in this category ranging in size from 15 to 500 kW. Small-scale facilities on residential rooftops, ranging from 1.5 to 5 kW in capacity, will comprise the remainder of the program and up to 10% of the total capacity.

On July 8, 2008, the Commission issued an Order setting the matter for hearing, directing Duke to give notice to its customers, and establishing discovery and other procedural deadlines.

Petitions to intervene were filed by the following parties and granted by order of the Commission: Carolina Utility Customers Association, Inc.; The Kroger Co.; Southern Alliance for Clean Energy; the North Carolina Sustainable Energy Association (NCSEA); Wal-Mart Stores East, LP, and Sam's East, Inc. (collectively, Wal-Mart); The Vote Solar Initiative (Vote Solar); and The Solar Alliance. The Attorney General filed a notice of

intervention on June 23, 2008, which is recognized pursuant to G.S. 62-20. Lastly, the intervention of the Public Staff is recognized pursuant to G.S. 62-15(d) and Commission Rule R1-19(e).

On July 25, 2008, Duke filed the direct testimony and exhibits of Janice D. Hager, Jane L. McManeus, Owen A. Smith, and Ellen T. Ruff.

On October 8, 2008, NCSEA filed the testimony Rosalie R. Day.

On October 10, 2008, pursuant to orders allowing extensions of time, Solar Alliance filed the testimony of Carrie Cullen Hitt, Vote Solar filed the testimony and exhibits of Thomas J. Starrs, Wal-Mart filed the testimony of Ken Baker, and the Public Staff filed the testimony and exhibits of Elise Cox and James McLawhorn.

On October 20, 2008, Duke filed the revised direct testimony of Ellen T. Ruff, the rebuttal testimony of Jane L. McManeus, and the rebuttal testimony and exhibits of Owen A. Smith.

This matter came on for hearing as scheduled on October 23, 2008. Duke presented the testimony and exhibits of witnesses Ruff, Smith, Hager and McManeus; Wal-Mart presented the testimony of witness Baker; Vote Solar presented the testimony and exhibits of witness Starrs; the Solar Alliance presented the testimony of witness Hitt; NCSEA presented the testimony of witness Day; and the Public Staff presented the testimony and exhibits of witnesses Cox and McLawhorn.

Based upon the foregoing, the testimony and exhibits introduced into evidence at the hearing, and the Commission's record of this proceeding, the Commission now makes the following

FINDINGS OF FACT

1. Duke is a public utility providing electric service to customers in its service area in North Carolina subject to the jurisdiction of the Commission.

2. The Commission has jurisdiction over this application. Pursuant to G.S. 62-110.1 and Commission Rule R8-61(b), a public utility must receive a CPCN prior to constructing electric generating facilities in North Carolina.

3. In its application, Duke requested authorization to install new solar PV electric generating facilities with a total capacity of approximately 20 MW (DC). These facilities will be dispersed throughout Duke's North Carolina service territory and will be installed as roof-mounted and ground-mounted facilities on the property of Duke's customers and on property owned by Duke. In its application, Duke estimated that the cost of the proposed facilities would be approximately $100 million. In its rebuttal

testimony, Duke reduced the size of its proposed program to 10 MW (DC), with an estimated cost of $50 million.

4. In order to meet the solar set-aside requirements of the North Carolina Renewable Energy and Energy Efficiency Portfolio Standard (REPS), G.S. 62-133.8(d), there is a need for Duke to acquire solar energy. Duke's proposed construction of 10 MW of solar PV generating facilities is an appropriate method for meeting a portion of this statutory requirement.

5. In addition to developing its program for construction of solar PV facilities on its own system, Duke also issued a request for proposals (RFP) which was open to bidders who could provide at least 2 MW of bundled renewable generation and renewable energy certificates (RECs). The RFP was not open to bidders with a capacity of less than 2 MW, to bidders offering RECs separately from the associated electric energy, or to providers of solar thermal energy.

6. The lowest solar bid submitted in response to Duke's RFP was from SunEdison. Duke has entered into a contract to purchase the energy and RECs offered by SunEdison.

7. Duke received numerous other solar bids in response to its RFP, many of which were priced lower per MWh than the estimated costs of Duke's program.

8. Duke employed an engineering firm, Black & Veatch, to analyze, in part, the bids submitted in response to its RFP. Duke had a reasonable opportunity to enter into contracts for solar energy and RECs from bidders in addition to SunEdison at a price lower than Duke's estimated costs for its program.

9. Duke anticipates that, in addition to simply providing solar energy to meet the REPS requirements, the program will provide certain additional benefits which it believes cannot be obtained through a purchase from a third party (collectively, "Broader Benefits"). These additional benefits include enabling Duke to develop competency as an owner of solar renewable assets; to leverage volume purchases; to build relationships with solar PV developers, manufacturers and installers; to gain experience with the installation and operation of various types of solar distributed generation (DG) facilities; and to evaluate the impact of such facilities on its electric system. In addition, Duke expects that the program will help it to understand the types of DG facilities desired by customers, promote the commercialization of solar facilities in North Carolina, and fill knowledge gaps so as to enable successful, widespread deployment of solar PV technologies. Moreover, Duke notes that, if it owns solar

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generating facilities, it will not be entirely dependent on purchases from outside entities to meet the solar requirements contained in the REPS.

10. Duke should not be required to make reports to the Commission on the information it gathers from the solar PV facilities installed in connection with the program or to gather comparable information from solar PV facilities owned by others.

11. The costs of Duke's program, like the costs of any purchase of bundled solar energy, include avoided costs that are quantifiable. Under G.S. 62-133.8(h), avoided costs are not incremental costs and may not be recovered through the REPS and REPS Experience Modification Factor (EMF) riders. Moreover, the avoided costs of Duke's program may not be recovered through the fuel and fuel-related costs rider under G.S. 62-133.2.

12. G.S. 62-133.8(h) states that incremental compliance costs may be recovered through the REPS and REPS EMF riders. G.S. 62-133.8(h)(1) provides that compliance costs must be "reasonable and prudent" in order to be recovered as incremental costs. To the extent that the total cost of the program exceeds the cost for which Duke could have reasonably purchased solar energy and RECs from a third party, Duke has not at this time met its burden of proving that these excess costs are reasonable and prudent costs incurred to comply with the REPS requirements and, therefore, eligible for recovery as incremental costs through the REPS and REPS EMF riders pursuant to G.S. 62-133.8(h)(1).

13. *The estimated total cost provided by Duke includes the costs associated* with the Broader Benefits of the program. G.S. 62-133.8(h)(1) provides that incremental costs include, among other things, "costs incurred by an electric power supplier to ... [c]omply with the requirements of subsections (b), (c), (d), (e), and (f)" of G.S. 62-133.8. The costs associated with the Broader Benefits of Duke's program will not be incurred to comply with the requirements of G.S. 62-133.8(b)-(f). Consequently, these costs may not be recovered through the REPS and REPS EMF riders, except to the extent that they may be shown in a future proceeding to constitute research and development expenses recoverable pursuant to G.S. 62-133.8(h)(1)(b). However, Duke is not precluded from asserting in a future general rate case proceeding that these costs have been incurred in a reasonable and prudent manner, including the initial decision to incur them, and that they are appropriate for inclusion in rate base and/or operating expenses for ratemaking purposes.

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14. The reasonable and appropriate costs to comply with G.S. 62-133.8(b)-(f) to be recovered by Duke through the REPS and REPS EMF riders shall not exceed the price offered in the third-lowest bid submitted in response to Duke's solar RFP, less avoided costs.

15. The public convenience and necessity require the implementation of Duke's proposed program, subject to the following conditions: (1) that the facilities constructed to implement the program shall not exceed a total of 10 MW in capacity, (2) that no more than a revenue requirement equivalent to the price offered in the third-lowest bid submitted in response to Duke's solar RFP, less avoided costs, may be recovered through the REPS and REPS EMF riders pursuant to G.S. 62-133.8(h)(1)(a), and (3) that in a future proceeding the Commission will determine whether the cost of the program in excess of the amount recoverable through the REPS and REPS EMF riders may be recovered in base rates.

16. Duke has estimated the construction cost of the program at $50 million. The Commission approves this estimate and finds, pursuant to G.S. 62-110.1(e), that construction of these facilities will be consistent with the Commission's plan for expansion of electric generating capacity; provided, however, that the Commission's approval of the estimate does not amount to approval of recovery of costs in excess of the level provided herein.

17. Duke should not be required to allow the host of a solar facility to retain a portion of the RECs produced by the facility or to retain a portion of the energy produced.

18. Duke should not be required to provide a standard offer for the purchase of solar RECs.

19. Duke, as a public utility, is required to follow certain tax normalization requirements with respect to the treatment of federal energy investment tax credits and accelerated depreciation. All costs necessary to comply with these requirements are both reasonable and prudent.

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EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 1-2

These findings of fact are essentially informational, jurisdictional and procedural in nature and are not controversial.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 3-4

The evidence supporting these findings of fact appears in Duke's application and in the testimony of Duke witnesses Ruff and Smith and Public Staff witnesses Cox and McLawhorn.

In August 2007, the General Assembly enacted Session Law 2007-397 (Senate Bill 3), which established a Renewable Energy and Energy Efficiency Portfolio Standard (REPS) in this State. G.S. 62-133.8. The REPS requires all North Carolina electric suppliers to include specified percentages of renewable generation in their generation portfolio. Subsection (d) of G.S. 62-133.8 provides that specified percentages "of the total

electric power in kilowatt hours sold to retail electric customers in the State, or an equivalent amount of energy, shall be supplied by a combination of new solar electric facilities and new metered solar thermal energy facilities ...." The required percentages of solar energy are 0.02% for 2010-11, 0.07% for 2012-14, 0.14% for 2015-17, and 0.20% for 2018 and subsequent years. Under G.S. 62-133.8(h), a utility may recover the incremental cost of compliance with the REPS from customers through an annual rider. The amount of the rider for any given customer account is subject to an annual limit (the "per-account cap"), which is set by the statute at different levels for residential, commercial and industrial customers. If a utility's incremental costs of compliance for a given year are equal to the combined total of the per-account caps for all its North Carolina retail customers (the "utility-wide ceiling"), the utility is conclusively deemed to be in compliance with the REPS for that year, notwithstanding its failure to achieve the percentages of renewable generation provided for in the statute. No incremental costs of REPS compliance in excess of the utility-wide ceiling may be recovered from ratepayers.

Duke witness Ruff testified that Duke's proposed solar PV facilities are "renewable energy facilities" within the meaning of the REPS statute and will enable Duke to partially fulfill its obligations under the REPS and the solar set-aside.

Duke witness Smith, in his direct testimony, provided a detailed description of the solar PV facilities that Duke proposes to install. He stated that the facilities are expected to have a total combined capacity of approximately 20 MW (DC), which will be converted to about 16 to 17 MW alternating current (AC). The facilities will be installed on both customer- and Company-owned property in Duke's North Carolina service area. They will consist of large- or medium-scale ground-mounted facilities and rooftop installations on commercial, industrial and residential buildings. The facilities will be installed over a two-year period following approval by the Commission, and their total cost is estimated to be $100 million. Witness Smith described Duke's proposed tariff for the program, and he explained that a blanket CPCN for the program is needed because the precise location of the facilities cannot be specified at this time and because waiting to determine such locations before filing multiple applications for individual CPCNs would unduly delay the program and increase its costs.

Public Staff witnesses Cox and McLawhorn testified that Duke's proposed program appears to be needed to meet the starting date for the solar set-aside requirements, but that it should be limited to 10 MW rather than the 20 MW proposed by Duke. In support of their recommendation to reduce the size of the project, witnesses Cox and McLawhorn noted that Duke has already entered into a contract to purchase solar energy from SunEdison. In combination with the SunEdison project, Duke's program will produce much more solar energy than is needed for compliance with the solar set-aside from 2010 through 2014. The witnesses stated that, while solar generation should be encouraged, it should not be pursued at the expense of other, less costly renewable resources because this could result in Duke's prematurely reaching the utility-wide ceiling established by G.S. 62-133.8(h). If Duke generates an excessive amount of costly solar energy, the total amount of renewable energy it can purchase or generate within the limits of its utility-wide cost cap will be reduced. This may result in a need to operate Duke's fossil-fired generating plants more often, possibly leading to increased emissions. Witnesses Cox

and McLawhorn further testified that, if Duke generates substantially more solar energy in 2010-14 than is needed for compliance with the solar set-aside, it could bank the RECs associated with the excess solar generation and use them in later years. However, in their view, this type of large-scale banking of solar RECs is not a desirable practice because (1) it raises issues of intergenerational equity and (2) there is a substantial possibility that the costs of solar power may decrease in future years. In that event, Duke will be spending money unwisely by accumulating large numbers of solar RECs in advance of the need for them.

Duke witness Smith stated in his rebuttal testimony that Duke had decided to reduce the size of the program from 20 MW to 10 MW and that this would reduce the cost of the program to $50 million. He testified that the proposed tariff for the program had been revised accordingly and was attached to his testimony as Smith Rebuttal Exhibit 1.

The Commission agrees with Duke and the Public Staff that the solar facilities Duke proposes to construct, not to exceed 10 MW in capacity, are needed for compliance with G.S. 62-133.8(d).

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 5-7

The evidence supporting these findings of fact appears in the testimony of Duke witness Smith and Public Staff witnesses Cox and McLawhorn.

Public Staff witnesses Cox and McLawhorn testified that they had reviewed the process used by Duke to solicit bids for renewable energy. Their review indicated that Duke issued an RFP for renewable energy in 2007 and received numerous solar bids in response. Duke's RFP was restricted to bidders offering bundled RECs and energy from facilities at least 2 MW in capacity. In addition, solar thermal projects, which do not produce any electricity, but do produce RECs that can be used to satisfy the REPS solar set-aside, were ineligible to submit bids.

On cross-examination, Duke witness Smith confirmed that the lowest solar bid in response to Duke's RFP was submitted by SunEdison, with which Duke has entered into a contract for solar energy and RECs. He stated that Public Staff Smith Confidential Cross-Examination Exhibit 1 is a listing, initially prepared by Duke, of the solar bids received in response to the RFP and the amounts of the bids, adjusted by Duke to be comparable with each other and with Duke's own proposal to facilitate easier comparison.

On these matters there is no disagreement among the parties. The Commission finds the facts to be as set forth above.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 8

The evidence supporting this finding of fact appears in the testimony of Public Staff witnesses Cox and McLawhorn and Duke witness Smith.

Public Staff witnesses Cox and McLawhorn testified that, in their review of Duke's RFP process, they ascertained that Duke had employed the firm of Black & Veatch to perform an analysis of the bids.

On cross-examination, Duke witness Smith testified that Public Staff Smith Confidential Cross-Examination Exhibit 2 was a summary of the Black & Veatch analysis, while Public Staff Smith Confidential Cross-Examination Exhibit 3 was a memorandum prepared by Black & Veatch setting out the results of the analysis in detail.

Although there may be some differences of opinion among the parties concerning the qualifications and reliability of some of the bidders responding to Duke's RFP, the Commission finds that Duke had a reasonable opportunity to enter into contracts for solar energy and RECs from bidders in addition to SunEdison at a price lower than Duke's estimated costs for its proposed program.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 9-10

The evidence supporting these findings of fact appears in the testimony of Duke witnesses Ruff and Smith, Solar Alliance witness Hitt, and Public Staff witnesses Cox and McLawhorn.

Duke witness Ruff testified that, in addition to providing solar energy to meet customer demand and to satisfy Duke's REPS obligations, the program will have a variety of other benefits. It will help promote the development of solar generation resources in North Carolina. The distributed nature of the generation of electricity under the program will enable Duke to develop competency as an owner of solar renewable assets; leverage volume purchases; build relationships with solar PV developers, manufacturers and installers; and gain experience with the installation and operation of multiple types of solar distributed generation (DG) facilities. Additionally, if Duke owns some of the generating facilities that it uses to meet the solar requirements of the REPS, it will not be dependent solely on power purchases to meet these requirements.

Duke witness Smith testified that the Program will facilitate Duke's evaluation of the impact of significant DG on Duke's electric system. In addition, it will allow Duke to explore the nature of solar DG offerings desired by customers; fill knowledge gaps to enable successful, wide-scale deployment of solar PV DG technologies; and promote the commercialization of the solar market in North Carolina through utility ownership. It will promote energy security, attract investment and create jobs in the solar industry, and drive down the cost of solar PV installations through standardizing inspection requirements and leveraging volume purchases.

Solar Alliance witness Hitt testified that she was in agreement with Duke that the program will enable Duke to learn more about solar PV. She supported Duke's proposal to collect information about the economic and physical impacts of its planned solar PV installations. She recommended that Duke be required to collect comparable information from a sampling of installations that it does not own and to make all of this information available to the public through the Commission.

Public Staff witnesses Cox and McLawhorn expressed agreement with Duke's witnesses that the Company, through its proposed program, seeks to obtain benefits that go beyond the simple acquisition of solar energy and RECs for REPS compliance purposes.

The Commission is not persuaded that Duke should be required to make arrangements with other owners of solar PV facilities to collect data comparable to the data it gathers with respect to its own facilities. This could potentially be a useful undertaking, however, and Duke is encouraged to collect such data if it chooses to do so. The Commission notes that the data gathered by Duke will be subject to discovery in future proceedings, particularly integrated resource planning proceedings; consequently, there is no need to require Duke to submit the data formally to the Commission in periodic reports. Duke should refrain from designating this information as confidential, except for any specific data items as to which secrecy is truly essential.

Aside from the issues raised by witness Hitt and addressed above, the parties are in agreement concerning the broader benefits, above and beyond the acquisition of solar energy, that Duke seeks to obtain by constructing its own solar generating facilities. The Commission finds the facts to be in accordance with the testimony of the parties.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 11

The evidence supporting this finding of fact appears in the testimony of Duke witness McManeus, NCSEA witness Day, and Public Staff witnesses Cox and McLawhorn.

In her direct testimony, Duke witness McManeus stated that Duke proposed to recover all of the costs of the program, except for avoided costs, through the REPS rider. The costs to be recovered through the REPS rider include not only operation and maintenance costs, but also capital costs, which will be calculated on a levelized basis using a fixed charge rate applied to the investment and reduced by avoided cost.

NCSEA witness Day testified that avoided capacity and energy costs should be subtracted from the incremental costs to be recovered through the REPS and REPS EMF riders.

Public Staff witnesses Cox and McLawhorn testified that Duke's original plan, as disclosed during discovery, was to deduct only avoided capacity costs from the total levelized costs of the program and to recover all the remaining costs (including avoided energy costs) through the annual REPS and REPS EMF riders. However, Duke subsequently changed its position and agreed to deduct all avoided costs from the costs to be recovered in the REPS rider. According to witnesses Cox and McLawhorn, Duke should not recover any avoided costs through either the REPS rider or the fuel and fuel-related costs rider; these costs should be recovered only through base rates.

In her rebuttal testimony and on cross-examination, Duke witness McManeus agreed that neither avoided energy costs nor avoided capacity costs should be recovered

through the REPS and REPS EMF riders. She further agreed that, given the language of G.S. 62-133.2(a1), these costs could not be recovered through the fuel adjustment rider either, but instead had to be recovered through base rates. She expressed concern, however, that the language of G.S. 62-133.2(a1) places utilities generating renewable energy through their own facilities at an unwarranted disadvantage in comparison with utilities that purchase renewable energy from third parties and are able to use the fuel adjustment rider for recovery of avoided costs.

As a result of the change in Duke's position, there is no longer any disagreement among the parties on this issue. The Commission concludes that, under G.S. 62-133.8(h)(1), neither avoided energy costs nor avoided capacity costs are included in the "incremental costs" that can be recovered through the REPS and REPS EMF riders; that, under G.S. 62-133.2(a1)(6), the avoided energy and capacity costs of "all purchases of power from renewable energy facilities and new renewable energy facilities pursuant to G.S. 62-133.8" can be recovered through the fuel and fuel-related costs rider; and that G.S. 62-133.2 does not authorize a utility to recover through the fuel and fuel-related costs rider the avoided costs associated with renewable energy that it generates on its own system.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 12-14

The evidence supporting these findings of fact appears in the testimony of Duke witnesses Ruff, Smith and McManeus, NCSEA witness Day, and Public Staff witnesses Cox and McLawhorn.

Duke witness Ruff testified that, as a result of constructing its own solar facilities, Duke will not be dependent solely on power purchases from third parties to meet the requirements of G.S. 62-133.8(d) and that it will be more in control of the facilities used to meet those requirements than if it had relied on another entity to construct them.

Duke witness Smith testified that it is inappropriate to compare the estimated cost of the program with the bids received in response to Duke's RFP because of the broader benefits that will be provided by the program, but that cannot be obtained through a purchase of solar power from a third party. He stated that, prior to filing its application in this docket, Duke considered whether it would be reasonable to divide the costs of the program between different recovery mechanisms based upon the multiple benefits of the program; however, Duke decided not to pursue this approach because all generation produced by the program will serve to meet the REPS requirements. On cross-examination, witness Smith indicated that any proposal to replace Duke's program with a purchase of power from one of the RFP bidders (in addition to the SunEdison purchase Duke has already agreed to) would require Duke to have full confidence that the RFP bidder's project would come to fruition, and Duke is not comfortable with making such an assumption.

Duke witness McManeus testified that she disagreed with the Public Staff's proposal to limit the amount of program costs recoverable through the REPS and REPS EMF riders. She testified that the goals of the program were different from, and more

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varied than, the goals that can be achieved through a simple purchase of power. Moreover, Duke would not have undertaken the program had the REPS legislation not been enacted, and all of the electricity generated by the program will be used for REPS compliance. On cross-examination, witness McManeus stated that it was not possible to break down the cost of the program into components representing the underlying cost of solar energy, the additional costs associated with the program's Broader Benefits, and the costs attributable to tax normalization. On cross-examination relating to Public Staff McManeus Confidential Cross-Examination Exhibit 1, she acknowledged that, if Duke chooses to generate solar energy through the program instead of purchasing it at a lower cost from a third party, it will reach the utility-wide ceiling established by G.S. 62-133.8(h) more quickly. If this occurs, then Duke will not be able to obtain as much renewable energy within the limits of the ceiling as it otherwise could; consequently, it will have to generate additional energy from its non-renewable facilities, possibly resulting in increased emissions.

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NCSEA witness Day testified that Duke's program is too expensive and that the costs of the program will consume an excessive portion of Duke's utility-wide ceiling. She stated that Duke should seek conventional power plant financing for the program, and that the only costs of the program that should be recovered through the REPS and REPS EMF riders (aside from research costs) are the operations, leasing and maintenance costs of the solar PV facilities, less avoided costs.

Public Staff witnesses Cox and McLawhorn testified that Duke's program is very expensive, as can be seen by comparing the bids received in response to the RFP with the estimated cost of the program. A major reason for the high cost of the program is that it is designed not only to obtain solar energy for REPS compliance, but also to gain broader benefits, such as expertise in dealing with a wide range of solar technologies, information about what Duke's customers desire with regard to solar energy, and increased familiarity with DG. In discovery, the Public Staff requested Duke to break down the capital costs of the program between actual solar generation costs and the costs associated with the program's broader goals, but Duke responded that it could not do so. Witnesses Cox and McLawhorn stated that only the actual cost of solar energy (minus avoided costs) should be recovered through the REPS and REPS EMF riders. In their judgment, while any quantification of the actual cost of solar energy would necessarily be somewhat subjective, the bid submitted by the third-place bidder, as stated on Public Staff Smith Confidential Cross-Examination Exhibit 1, is an appropriate quantification under the specific facts of this case. The remaining costs of the program, to the extent that they meet the requirements of G.S. 62-133.8(h)(1)(b), may be sought to be recovered as research costs under the statute.

On cross-examination, witness McLawhorn stated that, although the Public Staff's proposed limit on cost recovery through the REPS and REPS EMF riders was equal to the amount of the third-place bid, he and witness Cox were not contending that Duke necessarily should have agreed to purchase power from that bidder or that the costs in excess of this amount were necessarily imprudent; they were simply adopting the figure as an estimate of, or proxy for, the actual cost of solar energy.

On this very complex issue, the parties are sharply in disagreement. Duke has requested the Commission to affirm that it will be allowed to recover its costs associated with the program through the REPS and REPS EMF riders. In considering this request, the Commission will begin its analysis by reviewing the relevant statutory provisions. Under G.S. 62-133.8(h)(4), incremental costs may be recovered through the REPS and REPS EMF riders. The term incremental costs is defined in G.S. 62-133.8(h)(1), which contains three paragraphs, (a) through (c), that identify three different categories of incremental costs. Paragraph (c) has no bearing on this case, and paragraph (b) will be addressed in a later section of this order. Of critical importance is paragraph (a), which provides that incremental costs include costs incurred to "[c]omply with the requirements of subsections (b), (c), (d), (e), and (f) of this subsection [the REPS percentage requirements] that are in excess of the electric power supplier's avoided costs." Equally important is the introductory clause of G.S. 62-133.8(h)(1), which makes it clear that only "reasonable and prudent costs" qualify as incremental costs. Thus, the Commission must deal with the question of whether the costs of the program are reasonable and prudent costs incurred for the purpose of complying with the REPS.

It is clear from the evidence presented in this case that at least some portion of the costs of Duke's program will, in fact, be incurred to acquire solar energy for compliance with the REPS solar set-aside. It is also clear that at least some portion of the costs will be incurred for the purpose of achieving the program's previously-stated Broader Benefits.

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Duke contends that the costs of the program should be viewed as unitary and indivisible; all of the costs should be viewed as being incurred to promote all of the program's purposes, and all should be recoverable through the REPS rider. Duke points out that there is no clear or simple method of attributing some of the program costs to one purpose and some to another. All of the funds spent on the program will be necessary for the program's completion; all of the energy generated by the program will be used for REPS compliance; and the program would never have been proposed if the REPS legislation had not been enacted.

The Commission is concerned, however, that allowing full recovery of the program's costs, as proposed by Duke, may lead to results inconsistent with the public interest and that it may also be inconsistent with the General Assembly's intent.

In the first place, if Duke is allowed to recover all the costs of the program through the REPS and REPS EMF riders, it may reach the utility-wide incremental cost ceiling prematurely, setting a precedent for other utilities in the State. Other utilities will be encouraged to undertake costly projects that are designed not only to comply with the REPS, but also to promote other goals, knowing that the entire costs of the project can be recovered through the REPS and REPS EMF riders. As Duke witness McManeus acknowledged on cross-examination, if a utility generates renewable energy at a higher cost when it could instead have purchased equivalent energy from a third party at a lower cost and it subsequently reaches the utility-wide ceiling, the result is that it will not be able

to acquire as much renewable energy prior to reaching the ceiling as it could otherwise have acquired. Since the utility must meet its customer demand at all times, it must make up the shortfall in renewable generation by running its conventional plants for more hours, very likely resulting in increased emissions. In this way, the intent of G.S. 62-133.8 – to reduce emissions and protect the environment – will be thwarted.

Moreover, if Duke is allowed to recover all its program costs through the REPS and REPS EMF riders, this will not only have an adverse environmental effect, it will also be inconsistent with the goal of minimizing utility expenses and keeping rates down. Once the precedent has been set in this case, Duke and other utilities will be encouraged to undertake costly renewable generation projects that promote a variety of purposes in preference to less expensive projects designed solely for REPS compliance or purchases of renewable energy from third parties. They will know that, as long as a project produces some renewable energy, its entire cost (aside from avoided costs) can be recovered without any need for a rate case. The Commission believes that it is in the public interest for utilities to minimize the cost of REPS compliance and that the REPS and REPS EMF riders be restricted to costs that are truly intended for REPS compliance.

The Commission has steadfastly held that "least cost" considerations require the utility to test the market and to refrain from building generation if the required energy or capacity can be purchased at a lower cost and other considerations do not justify the construction of utility-owned generation. This issue was addressed explicitly in Duke's recent application for a CPCN to construct the Buck and Dan River natural gas-fired combined cycle facilities. Order Issuing Certificates of Public Convenience and Necessity, Docket No. E-7, Subs 791 and 832 (June 5, 2008). Analogously, the Commission's affiliate transaction rules impose a lower of cost or market rule on purchases by the utility. The rule should be no different in the case of renewable generation. While Senate Bill 3 allows a utility to meet its REPS requirement using its own generation, it also requires the utility to "implement demand-side management and energy efficiency measures and use supply side resources to establish the least cost mix of demand reduction and generation measures that meet the electricity needs of its customers." G.S. 62 133.9(b) (emphasis added). To allow Duke to recover any additional incremental costs through base rates would allow Duke effectively to recover more from its ratepayers for building its own solar generation that it could have paid to purchase such power and RECs in the market without adequate justification for that result.

Finally, it is the Commission's belief that when the General Assembly enacted G.S. 62-133.8, as well as other statutes providing for rate riders, the legislative intent was that these riders should be limited strictly to the purposes for which they were originally designed and that these statutory provisions should not be stretched to encompass other purposes. The General Assembly did not intend that riders be used to collect the entire costs of projects designed only partially to implement the goals of the rider.

The Commission, therefore, concludes that it is inappropriate to treat the costs of Duke's program as indivisible, with all costs being attributed to all the purposes of the program. Instead, it is necessary to attribute a portion of the costs to REPS compliance and a portion to other purposes. Only the reasonable and prudent costs specifically

attributable to REPS compliance may be recovered through the REPS rider pursuant to G.S. 62-133.8(h)(1)(a).

The evidence in this case shows that Duke had the opportunity to purchase solar energy from more than one bidder at a lower cost to its ratepayers. Instead, Duke is proposing to generate an equivalent amount of solar energy on its own system at a higher cost per MWh and to recover that amount, less avoided costs, through the REPS rider. Duke asserts that the broader benefits it hopes to gain from the program are sufficient to justify recovery of the program's costs through the REPS rider. However, Duke has described these benefits only in vague conceptual terms; it has not explained why it could not obtain a greater understanding of the effects of DG on its system in other ways at a much lower cost (or why the same benefits are not available through power purchases), and it has made no attempt to quantify the value of the broader benefits.

Duke asserts that it needs to be in control of its sources of generation, and that, if it constructs its own solar facilities, the risk of default will be lower than if it buys power from a facility built by a third party. However, Duke has presented no evidence that the lower-cost bidders lack the engineering or management skills to operate a solar generating facility efficiently, or that their financial condition is such as to pose a risk of default.

During the hearing, Duke appeared to take the position that a solar generating facility is comparable (with respect to the risk of default) to a nuclear plant, which can be brought to a complete shutdown in the event of a mechanical malfunction that creates a potentially unsafe condition and, consequently, requires extraordinary management and engineering skills or to a fossil plant which, similarly, may have to be reduced to a low output or shut down altogether in case of a problem with the boiler or emission controls. In fact, however, a solar PV facility, even a very large one, is quite different from a fossil or nuclear plant. It consists of an array of PV panels; even if one panel malfunctions, the others can continue to operate. Certainly, an entire solar facility may be rendered inoperable by a natural disaster or other catastrophic event, but Duke presented no evidence that it could protect its solar generating facilities against such eventualities more effectively than a third party could.

The Commission is not persuaded by Duke's argument that purchases from a third party are unreliable and would place Duke at risk of non-compliance with its REPS obligation. G.S. 62-133.8(d) provides that

> the Commission shall develop a procedure to determine if an electric power supplier is in compliance with the [solar set-aside] if a new solar electric facility or new metered solar thermal energy facility fails to meet the terms of its contract with the electric power supplier.

In its February 29, 2008 Order Adopting Final Rules, the Commission, in declining to include explicit language addressing this issue in its formal rules, implemented that statutory provision by stating

> The procedure for determining compliance adopted in the rules is through the review of an electric power supplier's REPS compliance report. An electric power supplier may petition the Commission to modify or delay the provisions of G.S. 62-133.7(d) and Rule R8-67(c)(5).

Thus, Duke is not without recourse if it has made a substantial, good faith effort to comply with the solar set-aside and, through no fault of its own, fails to meet the REPS requirement.

Given the very large difference between the costs of Duke's program and the costs at which power can be purchased from bidders who responded to Duke's solar RFP, Duke has failed to persuade the Commission that the costs of the program are all *reasonable and prudent costs of* REPS *compliance. As previously noted, this does not* mean that these costs must be disallowed or that Duke cannot carry its burden of demonstrating their prudence in a future case. It does mean, however, that the costs in excess of the limit established herein do not qualify as incremental costs within the meaning of G.S. 62-133.8(h)(1)(a).

Thus, with respect to the specific amount of costs to be attributed to REPS compliance, the Commission agrees with the Public Staff's witnesses that the effective price per MWh submitted by the third-place bidder in response to Duke's solar RFP is an appropriate amount at which to cap the level of compliance costs that are recoverable through the REPS and REPS EMF riders. As witnesses Cox and McLawhorn acknowledged, any specific amount is necessarily somewhat subjective given the circumstances of this case; but the Commission notes that this amount is approximately the amount at which Duke could have purchased power in response to its RFP, and it represents an amount significantly less than Duke's total costs.

Accordingly, the Commission finds that no more than the amount set forth above constitutes "reasonable and prudent costs incurred by an electric power supplier to ... *[c]omply with the requirements" of the REPS within the meaning of* G.S. 62-133.8(h)(1)(a), and no more than this amount may be recovered through the REPS and REPS EMF riders pursuant to paragraph (h)(1)(a).

It is important to emphasize that the Commission has given no consideration to disallowing any of the costs of Duke's program for imprudence. Except in very unusual circumstances, it would be inappropriate to disallow costs in a CPCN proceeding. Public Staff witness McLawhorn made it clear on cross-examination that the Public Staff did not propose that the Commission disallow any costs in this proceeding.

As the Commission has previously emphasized, the decision on this issue does not mean that the remaining costs of the program are being disallowed. For example, if Duke is able to demonstrate in a future case that some or all of these costs have been incurred prudently to "[f]und research that encourages the development of renewable energy, energy efficiency, or improved air quality," then it can recover those costs through the REPS and REPS EMF riders pursuant to paragraph (h)(1)(b) of G.S. 62-133.8, subject to the $1,000,000 per year limitation set out in that paragraph.

Additionally, if Duke is able to demonstrate in a future general rate case proceeding that the remaining costs of the program have been incurred in a reasonable and prudent manner, including the initial decision to incur them, and that they are appropriate for inclusion in rate base or operating expenses for ratemaking purposes, then it can recover those costs in base rates.

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EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 15

The evidence in support of this finding of fact is found in the testimony of Duke witnesses Smith and NCSEA witness Day.

NCSEA witness Rosalie Day testified that the term "private" investment in the preamble of Senate Bill 3 and in G.S. 62-3(a)(10) is meant to encourage non-utility investment in renewable generation and to exclude investment by investor-owned utilities.

Duke witness Smith disagreed, contrasting private investment with government funding. He explained that, because Duke is owned by its investors, its investment in the program also constitutes private investment in renewable energy within the meaning of G.S. 62-2(a)(10).

The Commission is not persuaded by the arguments put forth by NCSEA witness Day. The term "private investment" is not defined in Senate Bill 3. According to its common definition, "private" means "not established and maintained under public funds" The Random House Dictionary (1980). Furthermore, Senate Bill 3 clearly allows for REPS compliance through the generation of energy from utility-owned new renewable energy facilities. G.S. 62-133.8(b). As a result, it would be incongruous for this Commission to interpret the policy statements contained in G.S. 62-3(a)(10) to exclude utility investment in renewable energy.

The Commission's findings with respect to the need for Duke's proposed program, the appropriate size of the program, and the regulatory treatment of the costs of the program lead to the conclusion that the Certificate of Convenience and Necessity requested by Duke should be granted, but only on the conditions that (1) the total capacity of the program be limited to 10 MW, (2) the costs of the program to be recovered through the REPS and REPS EMF riders pursuant to G.S. 62-133.8(h)(1)(a) be limited as stated herein, and (3) in a future proceeding the Commission will determine whether the cost of the program in excess of the amount recoverable through the REPS and REPS EMF riders may be recovered in base rates.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 16

The evidence supporting this finding of fact appears in the testimony of Duke witnesses Smith and Hager and Wal-Mart witness Baker.

Duke witness Smith stated in his rebuttal testimony that the estimated cost of the solar generating facilities to be constructed in connection with Duke's proposed program is $50 million. He stated that, if Duke's cost estimate is lower or higher than what is

actually achieved, any variance would have been reflected in the cost recovery mechanism under Duke's proposal.

Duke witness Hager testified that the program conforms to, and is an important and necessary part of, Duke's integrated resource plan for meeting customer capacity and energy needs.

Wal-Mart witness Baker testified that Duke's filing does not contain enough information to explain how Duke proposes to acquire solar panels at $5,000 per kW and that the Commission should consider capping the costs of the program.

Although various parties disagreed with Duke's proposals for recovery of the costs of the program, no party took issue with witness Smith's testimony that the total capital costs of the program are currently estimated to be $50 million. Neither did any party disagree with the testimony of witness Hager that the program is consistent with Duke's integrated resource plan. The Commission therefore finds the facts to be in accordance with these witnesses' testimony. Recovery of the program's costs shall be limited, not as proposed by Wal-Mart, but as set forth herein.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 17

The evidence supporting this finding of fact appears in the testimony of Duke witness Smith and Wal-Mart witness Baker.

Wal-Mart witness Baker testified that Duke should be required to allow the host of a solar PV facility to retain a portion of RECs generated by the facility as compensation and that Duke should be required to allow the host the option to take some portion of the electricity generated by the facility.

Duke witness Smith testified that Duke's inclination is to offer cash as compensation for siting the solar PV facility on a customer's roof, but that Duke would like the flexibility to structure the lease agreement in a manner that would be prudent for fulfilling the program. He further stated that cash compensation for the use of the premises can effectively result in the same outcome for the host with much less complexity than compensation by means of retaining RECs or retaining some of the electricity produced. Duke would prefer the flexibility to finalize such decisions related to the lease agreement after its market research studies have concluded.

Based on the foregoing, the Commission concludes that it is inappropriate to require Duke to allow the host of the solar facilities to retain a portion of the RECs or to retain a portion of the energy generated, although compensation in the manner described by Wal-Mart witness Baker represents an option that is available to Duke. Duke should be allowed some flexibility in structuring the lease agreements to appropriately compensate the lessee.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 18

The evidence in support of this finding of fact is found in the testimony of Duke witness Smith, NCSEA witness Day, Vote Solar Initiative witness Starrs, and Solar Alliance witness Hitt.

Solar Alliance witness Hitt and Vote Solar witness Starrs both advocated the establishment of a mandatory standard REC purchase offer. Witness Starrs testified that requiring Duke to provide a long-term standard offer for solar RECs at a price equal to the cost of the program to the Company will potentially lower costs to customers. Witness Hitt echoed this sentiment. NCSEA witness Day advocates that "a certain amount" of solar market share should be reserved for customer-generators, which essentially would require utilities to purchase RECs from such customers.

Duke witness Smith testified that NCSEA's, the Solar Alliance's, and Vote Solar's apparent position is that Duke should be required to purchase RECs from any solar customer-generator at a price that is the higher of Duke's cost to implement the program or the amount needed for the customer-generator to earn an internal rate of return of 9% - 12% on its investment. Witness Smith contended that witnesses Starrs' and Hitt's supposition that a "must take" obligation at this price would result in lower costs to customers is untenable, and the overall parameters for the REC purchase model are unacceptable. For example, witness Smith testified that if too few customers acted on the incentive provided by the REC purchase model, and Duke had relied on it for compliance, the Company would not be able to comply with the REPS requirements. Alternatively, if a large number of customers acted on this incentive and Duke had no way to limit customer participation, it could exceed its REPS cost caps. Witness Smith also testified that Duke already is developing a standard REC offer which it would make available to customer-generators on an as needed basis for RECs for general and solar set-aside compliance based upon current market prices. Although Duke has not finalized the interval for updating pricing of the offer, witness Smith testified that a reasonable approach that it is considering is one where pricing would be updated quarterly. He testified that a key purpose of the standard offer is to create a streamlined approach to interacting with owners of small generators that produce relatively small quantities of RECs.

The Commission disagrees with witnesses Day, Starrs, and Hitt, and declines to require the Company to provide a standard REC offer for the purchase of solar RECs. Such a requirement would essentially mandate that utilities purchase RECs from customer-generators. The Commission has already ruled that Senate Bill 3 does not impose a mandatory REC purchase obligation on electric power suppliers. In its February 29, 2008 Order Adopting Final Rules in Docket No. E-100, Sub 113, the Commission stated that "the electric power suppliers are not ... obligated to purchase all RECs offered for purchase. The Commission is not persuaded that it is appropriate to impose such an obligation." The Commission is not persuaded that it is appropriate to do so now. Duke is only obligated to purchase enough solar energy to comply with the solar set-aside and is not obligated to purchase as much solar energy as customers are willing to provide.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 19

The evidence supporting this finding of fact appears in the testimony of Duke witness McManeus.

Duke witness McManeus testified that, as a public utility, Duke is required to follow certain tax normalization requirements with respect to the treatment of the federal energy investment tax credit. Non-utilities, such as the bidders responding to Duke's RFP, are not subject to these tax normalization requirements.

Although it can be safely presumed that the bidders are not public utilities subject to the tax normalization requirements, other aspects of costs or cost savings implicitly included in the bidders' prices are not known. Furthermore, all of the qualitative and quantitative differences between the bidders' costs implicitly recovered in their prices and the costs of Duke's project are not known; therefore, the specific factors causing the differences between the bidders' prices and Duke's own cost cannot be fully detailed. These factors are in fact largely irrelevant to Duke's decision as to which path to follow, as well as the Commission's decision as to how much of Duke's costs is eligible for recovery through the REPS and REPS EMF riders. It is enough to know that there is a difference between the cost of the project proposed by Duke and the bidders' prices; that alone, and not the cause of the differential, is a sufficient basis on which the Commission can make its decision.

The Commission expects and desires Duke to remain in full compliance with the IRS tax normalization rules, and nothing in this order is intended to prevent the Company from so being in compliance. The purpose of this order is to determine whether a CPCN should be granted to Duke for its proposed project, and to what portion of the project's total cost is eligible for inclusion in the REPS and REPS EMF riders. To determine that amount, the Commission has utilized the bids received by the Company to establish what portion of the costs are eligible for recovery through the riders, and what portion is eligible for recovery only through the general rate case ratemaking process. As previously noted, the Commission's determination in this regard does not mean that the costs not eligible for inclusion in the riders must be disallowed or that Duke cannot carry its burden of demonstrating their prudence in a future rate case. To the contrary, in light of the severely adverse consequences to the Company and its customers that would result from non-compliance with both the ITC and depreciation normalization rules, the Commission concludes that any costs of complying with those requirements are, in fact, both reasonable and prudent.

IT IS, THEREFORE, ORDERED as follows:

1. That Duke's application for a Certificate of Public Convenience and Necessity to implement its proposed solar photovoltaic distributed generation program and to construct the associated generating facilities is hereby approved, subject to the conditions set forth herein below. This order shall constitute the certificate.

Deleted: . She further testified that the estimated cost of Duke's program is higher than the costs associated with a number of the bids received in response to the RFP due, in part, to these tax normalization requirements. On cross-examination, however, witness McManeus stated that it was not possible to break down the cost of the program into components representing the underlying cost of solar energy, the additional costs associated with the program's broader benefits, and the additional costs attributable to tax normalization.

Deleted: Duke asserts, through the testimony of witness McManeus, that its federal tax normalization obligations provide a valid justification for the high costs of the program. The Commission disagrees. As for the Company's higher cost, the Commission notes that Duke decided to build its own solar generation before the tax credit was even extended to regulated utilities and its cost was even higher in its initial application than proposed in its rebuttal testimony. Moreover, the Commission is aware that various factors affect the bid prices submitted and the associated cost estimates of the various solar projects. For example, the federal tax normalization issue does not explain the significant difference between the per-MWh Duke cost estimate and SunEdison's per-MWh cost.¶ The Commission does not agree with witness McManeus that the difference between the bidders' responses and the cost of Duke's own project can be directly attributed to the costs of tax normalization.

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Deleted: In issuing this order, the Commission emphatically does not intend to specifically disallow the costs of tax normalization. In order to ensure that the Company is in compliance with the rules, the Commission concludes that the Company should account for the project by determining, on a pr ... [2]

2. That the generating facilities constructed pursuant to this order shall not exceed a total of 10 MW (DC) in capacity.

3. That no more than a revenue requirement calculated to provide recovery equivalent to the effective price per MWh submitted by the third-place bidder in response to Duke's solar RFP, as stated in Public Staff Smith Confidential Cross-Examination Exhibit 1, less Duke's avoided costs, may be recovered through the REPS and REPS EMF riders pursuant to G.S. 62-133.8(h)(1)(a). This restriction is without prejudice to Duke's right to apply for recovery of any remaining costs of the program pursuant to G.S. 62-133.8(h)(1)(b), or as part of the base rates established pursuant to G.S. 62-133.

4. That Duke's cost of complying with the ITC and depreciation normalization rules are reasonable and prudent.

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5. That the facilities certificated herein shall be constructed and operated in strict accordance with all applicable laws and regulations.

6. That the issuance of this Order does not constitute approval of the final costs associated herewith for ratemaking purposes and this Order is without prejudice to the right of any party to take issue with the ratemaking treatment of the final costs in a future proceeding.

7. That Duke's proposed tariff designated as Smith Rebuttal Exhibit 1, and entitled "Solar Photovoltaic Distributed Generation Program (NC)," is approved.

ISSUED BY ORDER OF THE COMMISSION.

This the _____ day of December, 2008.

NORTH CAROLINA UTILITIES COMMISSION

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Gail L. Mount, Deputy Clerk

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Even given the Commission's conclusion regarding what portion of the project's cost may be passed through to ratepayers in the REPS and REPS EMF riders and what portion may only be recoverable through base rates, the Company is still responsible for assessing the prudence of proceeding with the project, and, should it proceed, for ensuring that all costs incurred in constructing and operating the project are reasonable and prudently incurred, just as the Company would be for any other capital project it undertook, whether or not that project received tax benefits subject to the tax normalization rules. In short, the Company is not by virtue of this order placed in a position vis-à-vis ratemaking any different than it would be in with regard to any other capital project constructed prior to the general rate case proceeding that examined the prudence and reasonableness of that construction process and its costs. Such has been the situation for a multitude of utility projects in the past, and that circumstance has never placed the Company at risk of being in violation of the tax normalization requirements

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In issuing this order, the Commission emphatically does not intend to specifically disallow the costs of tax normalization. In order to ensure that the Company is in compliance with the rules, the Commission concludes that the Company should account for the project by determining, on a pro rata basis based on the provisions of this order and actual costs incurred, subject to Commission approval, the portion of the project's cost that is potentially eligible for inclusion in the REPS and REPS EMF riders and the portion that is potentially eligible for inclusion in base rates. For each of these portions, the Company shall calculate its costs and revenue requirements in a manner that is in compliance with the tax normalization rules, just as it would for any other capital project. To the extent that any portion of the project is disallowed in a future rate proceeding as imprudent or unreasonable, the Company shall account for such disallowance in the same pro rata manner.