STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-100, SUB 127

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities – 2010	)))	ORDER ESTABLISHING STANDARD RATES AND CONTRACT TERMS FOR QUALIFYING FACILITIES

HEARD: Tuesday, January 25, 2011, at 9:00 a.m. in the Commission Hearing Room, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina 27603

BEFORE: Commissioner William T. Culpepper, III, Presiding, Chairman Edward S. Finley, Jr., and Commissioners Lorinzo L. Joyner, Bryan E. Beatty, Susan W. Rabon, ToNola D. Brown-Bland, and Lucy T. Allen

APPEARANCES:

For Duke Energy Carolinas, LLC:

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For Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc.:

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For Virginia Electric and Power Company, d/b/a Dominion North Carolina Power:

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For the Using and Consuming Public:

Gisele L. Rankin, Staff Attorney, Public Staff – North Carolina Utilities Commission, 4326 Mail Service Center, Raleigh, North Carolina 27699-4326

BY THE COMMISSION: These are the current biennial proceedings held by the North Carolina Utilities Commission pursuant to the provisions of Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) and the Federal Energy Regulatory Commission (FERC) regulations implementing those provisions, which delegated responsibilities in that regard to this Commission. These proceedings also are held pursuant to the responsibilities delegated to this Commission under G.S. 62-156(b) to establish rates for small power producers as that term is defined in G.S. 62-3(27a).

Section 210 of PURPA and the regulations promulgated pursuant thereto by the FERC prescribe the responsibilities of the FERC and of state regulatory authorities, such as this Commission, relating to the development of cogeneration and small power production. Section 210 of PURPA requires the FERC to prescribe such rules as it determines necessary to encourage cogeneration and small power production, including rules requiring electric utilities to purchase electric power from, and to sell electric power to, cogeneration and small power production facilities. Under Section 210 of PURPA, cogeneration facilities and small power production facilities that meet certain standards and are not owned by persons primarily engaged in the generation or sale of electric power can become qualifying facilities (QFs), and thus become eligible for the rates and exemptions established in accordance with Section 210 of PURPA.

Each electric utility is required under Section 210 of PURPA to offer to purchase available electric energy from cogeneration and small power production facilities that obtain qualifying facility status under Section 210 of PURPA. For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, are in the public interest, and do not discriminate against cogenerators or small power producers. The FERC regulations require that the rates electric utilities pay to purchase electric energy and capacity from qualifying cogenerators and small power producers reflect the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy or capacity from other suppliers.

With respect to electric utilities subject to state jurisdiction, the FERC delegated the implementation of these rules to the state regulatory authorities. State commissions may implement these rules by the issuance of regulations, on a case-by-case basis, or by any other means reasonably designed to give effect to the FERC's rules.

The Commission determined to implement Section 210 of PURPA and the related FERC regulations by holding biennial proceedings. The instant proceeding is the latest such proceeding to be held by this Commission since the enactment of PURPA. In prior biennial proceedings, the Commission has determined separate avoided cost rates to be paid by electric utilities to the QFs with which they interconnect. The Commission also has reviewed and approved other related matters involving the relationship between the electric utilities and such QFs, such as terms and conditions of service, contractual arrangements and interconnection charges.

This proceeding also is a result of the mandate of G.S. 62-156, which was enacted by the General Assembly in 1979. This statute provides that "no later than March 1, 1981, and at least every two years thereafter" the Commission shall determine the rates to be paid by electric utilities for power purchased from small power producers according to certain standards prescribed therein. Such standards generally approximate those prescribed in the FERC regulations regarding factors to be considered in the determination of avoided cost rates. The definition of the term "small power producer" for purposes of G.S. 62-156 is more restrictive than the PURPA definition of that term, in that G.S. 62-3(27a) includes only hydroelectric facilities of 80 MW or less, thus excluding users of other types of renewable resources.

On May 5, 2010, the Commission issued its Order Establishing Biennial Proceeding, Requiring Data and Scheduling Public Hearing. That Order made Carolina Power and Light Company, d/b/a Progress Energy Carolinas, Inc. (PEC); Duke Energy Carolinas, LLC (Duke); Virginia Electric and Power Company, d/b/a Dominion North Carolina Power (NC Power); and Western Carolina University (WCU) parties to the proceeding in order to establish the avoided cost rates each is to pay for power purchased from QFs pursuant to the provisions of Section 210 of PURPA and the associated FERC regulations and G.S. 62-156. The Order also required each electric utility to file proposed rates and proposed standard form contracts.

This procedural order also stated that the Commission would attempt to resolve all issues arising in the docket based on a record developed through public witness testimony, written statements, exhibits and avoided cost schedules verified by persons who would otherwise be qualified to present expert testimony in a formal hearing, and written comments on the statements, exhibits and schedules, rather than a full evidentiary hearing. PEC, Duke, NC Power, and WCU were required to file their statements and exhibits by November 1, 2010. Other persons desiring to become parties were allowed to intervene and file their comments and exhibits by January 10, 2011. All parties were allowed to file reply comments and proposed orders. The deadlines for comments, reply comments, and proposed orders were subsequently extended to February 22, March 30, and April 27, 2011**,** respectively. The Commission scheduled a public hearing for January 25, 2011, solely for the purpose of taking non-expert public witness testimony. Finally, the Commission required PEC, Duke, NC Power, and WCU to publish notice and submit Affidavits of Publication no later than the date of the hearing.

WCU filed its comments and proposed rates on October 21, 2010. PEC, Duke and NC Power filed their initial statements and exhibits on November 1, 2010. Duke filed a revised initial statement on November 29, 2010. NC Power also filed a comparison of avoided cost payments on July 15, 2010, and January 12, 2011.

In addition to the Public Staff-North Carolina Utilities Commission (Public Staff), the following parties filed timely petitions to intervene that were granted: the Public Works Commission of Fayetteville (Fayetteville), the North Carolina Sustainable Energy

Association (NCSEA), the Carolina Industrial Group for Fair Utility Rates I, II, and III (CIGFUR), Carolina Utility Customers Association, Inc. (CUCA), and Charles B. Mierek.

The hearing scheduled for January 25, 2011, for the purpose of taking non-expert public witness testimony was held as scheduled. No witnesses appeared at this hearing.

On March 1, 2011, pursuant to a further extension of time, the Public Staff filed its initial statement. On March 2, 2011, New River Light and Power Company (New River) filed its comments and avoided cost rates. On March 16, 2011, WCU filed a clarification of its exhibits. Pursuant to a further extension of time, PEC, Duke, and NC Power filed reply comments on April 4, 2011. On April 20, 2011, New River submitted a revised avoided cost filing. Proposed orders were filed by NC Power, PEC, Duke, and the Public Staff on April 29, 2011.

Various filings were made and orders issued which are not discussed in this order but are included in the record of this proceeding.

Based on the entire record in this proceeding, the Commission now makes the following

FINDINGS OF FACT

1. PEC should be required to offer long-term levelized capacity payments and energy payments for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell five megawatts (MW) or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years should include a condition making contracts under those options renewable for subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other relevant factors or (2) set by arbitration. PEC should offer its standard five-year levelized rate option to all other qualifying facilities contracting to sell 3 MW or less capacity.

2. Duke should be required to offer long-term levelized capacity payments and energy payments for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell 5 MW or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years should include a condition making contracts under those options renewable for

subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other relevant factors or (2) set by arbitration. Duke should offer its standard five-year levelized rate option to all other qualifying facilities contracting to sell 3 MW or less capacity.

3. NC Power should be required to offer long-term levelized capacity payments and energy payments calculated pursuant to the differential revenue requirement (DRR) method based on long-term levelized generation mixes with adjustable fuel prices for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell 5 MW or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years should include a condition making contracts under those options renewable for subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other relevant factors or (2) set by arbitration. The standard five-year levelized rate option should be offered to all other qualifying facilities contracting to sell 3 MW or less capacity. Long-term levelized energy payments should be offered as an additional option for small qualifying facilities rated at 100 kW or less capacity.

4. NC Power should be required to file in the next avoided cost proceeding proposed fixed long-term, levelized avoided energy rates for five-year, ten-year and 15-year periods for QFs entitled to standard contracts.

5. It is appropriate for NC Power to offer, as an alternative to avoided cost rates derived using the DRR method, avoided cost rates based upon market clearing prices derived from the markets operated by PJM Interconnection, LLC (PJM), subject to the same conditions as approved in the 2006 biennial avoided cost proceeding (Docket No. E-100, Sub 106).

6. PEC, Duke, and NC Power should offer QFs not eligible for the standard long-term levelized rates the following three options if the utility has a Commission-recognized active solicitation underway: (1) participating in the utility's competitive bidding process, (2) negotiating a contract and rates with the utility, or (3) selling energy at the utility's Commission-established variable energy rate. If the utility does not have a Commission-recognized active solicitation underway, it should offer QFs not eligible for the standard long-term levelized rates the option of (1) contracting with the utility to sell power at the variable energy rate established by the Commission in these biennial proceedings or (2) contracting with the utility to sell power at negotiated rates. If the utility does not have a solicitation underway, any unresolved issues arising during such negotiations will be subject to arbitration by the Commission

at the request of either the utility or the QF for the purpose of determining the utility's actual avoided cost, including both capacity and energy components, as appropriate; however, the Commission will conduct such an arbitration only if the QF is prepared to commit its capacity to the utility for a period of at least two years. In either case, whether there is an active solicitation underway or not, QFs not eligible for standard long-term levelized rates have the option of selling into the wholesale market. The exact points at which an active solicitation should be regarded as beginning and ending for these purposes should be determined by motion to, and order of, the Commission. Unless there is such a Commission order, it will be assumed that there is no solicitation underway. If the variable energy rate option is chosen, such rate may not be locked in by a contract term, but shall instead change as determined by the Commission in the next biennial proceeding.

7. Both the peaker method and the DRR method are generally accepted and used throughout the electric utility industry and are reasonable for use in this proceeding.

8. A performance adjustment factor (PAF) of 2.0 should be utilized by PEC and Duke in their respective avoided cost calculations for hydroelectric facilities with no storage capability and no other type of generation. PEC and Duke should use a PAF of 1.2 for all other QFs.

9. PEC's avoided energy costs should be calculated using the PROSYM Total System Cost output data, which includes start costs.

10. The contract clauses currently in place by Duke and NC Power that limit the availability of standard long-term contract rates in the time period immediately prior to the approval of new biennial rates are reasonable and should continue to be allowed.

11. PEC's proposed incorporation into the current framework of a viability prerequisite for QFs eligible for standard contracts should be rejected.

12. NC Power's inclusion of a regulatory disallowance clause in its standard contract for purchases of energy and capacity pursuant to Schedule 19-DRR is reasonable and should continue to be allowed.

13. The rate schedules and standard contract terms and conditions proposed in this proceeding by PEC, Duke, and NC Power should be approved except as otherwise discussed herein. The utilities should be required to file new versions of their rate schedules and standard contracts, in compliance with this Order, within 20 days after the date of this Order. Those rate schedules and standard contracts should be allowed to go into effect ten days after they have been filed unless specific objections as to the accuracy of the calculations and conformity to the decisions herein are filed within that ten-day period.

14. The avoided cost rates for WCU and New River, as filed, should be approved on an interim basis pending further order of the Commission.

DISCUSSION AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-2

No party to this proceeding proposed to change the availability of long-term levelized rate options for the specified QFs contracting to sell 5 MW or less capacity or the availability of five-year levelized rate options to all other qualifying facilities contracting to sell 3 MW or less capacity. The Commission has consistently concluded in prior avoided cost proceedings that it must reconsider the availability of long-term levelized rate options as economic circumstances change from one biennial proceeding to the next and that, in doing so, it must balance the need to encourage QF development, on the one hand, and the risks of overpayments and stranded costs on the other. The Commission continues to believe that its decisions in the most recent past avoided cost proceedings strike an appropriate balance between these concerns. The Commission, therefore, concludes that PEC and Duke should each continue to offer long-term levelized rate options of five-, ten- and 15-year terms to hydro QFs contracting to sell 5 MW or less and to QFs contracting to sell 5 MW or less that are fueled by trash or methane from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass, and that they should offer their five-year levelized rate options to all other qualifying facilities contracting to sell 3 MW or less capacity. With these limitations, long-term contract options serve important statewide policy interests while reducing the utilities' exposure to overpayments and should continue to be made available.

DISCUSSION AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 3-5

In its filing, NC Power maintained that its proposed locational marginal pricing methodology offered several benefits, including the fact that it is transparent to all parties, it would enable QFs to make prudent decisions regarding the running of their facilities to maximize their revenues, and it more accurately reflects true avoided costs. Under this proposal, QFs would be paid for delivered energy and capacity the equivalent of what NC Power would have paid PJM if the QF generator had not been generating. The avoided energy rates to be paid to larger QFs with a design capacity of greater than 10 kW would be the PJM Dominion Zone Day-Ahead hourly locational marginal prices (LMPs) divided by ten, and multiplied by the QF's hourly generation, while smaller QFs that elect to supply energy would only be paid the average of the PJM Dominion Zone Day-Ahead hourly LMPs for the month as shown on the PJM website.

Capacity credits for Schedule 19-LMP would be paid on a cents per kWh rate for the 16 on-peak daily hours (7 a.m. to 11 p.m.) for all days. NC Power used the PJM Reliability Pricing Model (RPM) to determine its avoided capacity costs, which are the prices per MW per day from PJM's Base Residual Auction for the Dom Zone. As proposed in the last proceeding, NC Power adjusted the avoided capacity rate using a Summer Peak Performance Factor (SPPF) as an incentive for QFs to operate during

PJM system peak days. The calculation of the SPPF incorporated historical operational data on five individual days during the prior year's summer peak season (defined by PJM as the period June 1 through September 30). The SPPF will vary depending upon the QF's prior year's operations.

NC Power also filed avoided energy costs using the DRR method, which is a more traditional method used to determine avoided costs. NC Power's avoided energy rates were determined using PROMOD, a production simulation model developed by Ventyx Energy, LLC, to estimate its marginal avoided fuel costs for on-peak and off-peak periods over the next 15 years. NC Power incorporated a "base" case and "with" QF capacity case with the resulting output used to determine the avoided energy rates and energy mixes. The Public Staff, in its initial statement, stated that, based upon its review, it believes the inputs into the model and the output data from the model are reasonable for the determination of NC Power's avoided energy costs.

For capacity, NC Power's Schedule 19-DRR included a payment for capacity that incorporated the PJM RPM as a proxy for avoided capacity costs for 2011 through 2013. NC Power then used forecasted capacity prices from ICF International, Inc., for 2014 through 2026. The Public Staff stated in its initial statement that it performed a comparison of these forward prices to the costs of a CT projected by Duke and PEC. While the influence of the RPM significantly lowers the five-year capacity rate, the ten-year and 15-year rates are comparable to the rates proposed by Duke and PEC that reflect the installed cost of a CT. In conclusion, the Public Staff stated that it did not object to the proposed forward capacity costs being used to determine the avoided capacity rates for NC Power in this proceeding, but that it intended to review the use of the RPM prices as a proxy in future proceedings.

In its initial statement, the Public Staff raised the issue as to whether NC Power's standard rate options are sufficiently fixed to comply with the FERC's recent interpretation of PURPA in J.D. Wind 1, LLC, 130 FERC ¶ 61,127 (2010), denying reh'g, 129 FERC ¶ 61,148 (2009) (J.D. Wind). In J.D. Wind, the FERC stated that its intention in its Order No. 69 was to enable a QF "to establish a fixed contract price for its energy and capacity at the outset of its obligation." J.D. Wind, ¶ 23 (quoting FERC Order No. 69, FERC Stats. & Regs. ¶ 30,128, at 30,880). The FERC went on to say that it has "consistently affirmed the right of QFs to long-term avoided cost contracts or other legally enforceable obligations with rates determined at the time the obligation is incurred, even if the avoided costs at the time of delivery ultimately differ from those calculated at the time the obligation is originally incurred." J.D. Wind, ¶ 23.

The Public Staff further stated that standard rate options for NC Power historically have included changes based upon long-term levelized generation mixes with adjustable fuel prices for QFs larger than 100 kW that are otherwise eligible for the standard rate options. Thus, only the first two years of a 15-year standard contract are fixed and stated in the tariff. See NC Power's filing of November 1, 2010, Schedule 19-DRR, Section VI(B). Given J.D. Wind and this Commission's interpretation of the FERC's orders, the Public Staff argued that this is not consistent with PURPA.

In its proposed order, NC Power explained that, under the Company's proposed Schedule 19-DRR, energy rates for QFs above 100 kW are fixed in two year increments over the life of NC Power's standard Purchase Power Agreement for the Sale of Electrical Output (PPA) through one of two methods. A QF may elect to (1) receive the energy payment approved by the Commission in each biennial proceeding, or (2) receive energy payments based on long-term levelized generation mixes with adjustable fuel prices.

NC Power noted that this biennial reset method for energy payments is not a recent development. The method was first approved by the Commission on an experimental basis in the 1989 avoided cost proceeding in Docket No. E-100, Sub 57. The Commission granted permanent approval to the existing Schedule 19-DRR energy rate method in the 1991 avoided cost proceeding in Docket No. E-100, Sub 59.

NC Power acknowledged that, in adopting its PURPA regulations, FERC recognized that "in order to be able to evaluate the financial feasibility of a [QF], an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction of a facility." J.D. Wind, ¶ 23 (quoting FERC Order No. 69, FERC Stats. & Regs. ¶ 30,128, at 30,868). NC Power argued that its Schedule 19-DRR energy pricing mechanism achieves this objective while at the same time protecting the interests of ratepayers.

NC Power contended that its energy mix approach reflects the different purposes of the capacity and energy rates in a typical project financed QF PPA. The capacity rate, which was and continues to be fixed over the term of the contract, is intended to cover the financing cost associated with a facility, while the energy rate is intended to recover the cost of fuel and O&M, which can vary over time. The Company's energy mix approach to energy rates under Schedule 19-DRR allows energy rates to reset according to fluctuations in commodity and O&M costs, which benefits both QFs and ratepayers. NC Power submitted that its existing energy payment mechanism, coupled with the fixed capacity payment, has and most likely will continue to provide investors with the reasonable certainty required for financing small QFs.

In addition, NC Power argued that its method protects both the QF and ratepayers from the ill effects resulting from the inherent likelihood of error in fixed energy prices based on long-term forecasts of generation mixes and fuel prices. According to the Company, predicting long-term fixed energy rates with accuracy is extremely difficult because of such factors as (1) the potential for new and more restrictive environmental regulations such as carbon legislation, (2) the increased emphasis on renewable energy at premium prices, (3) renewed interest in energy conservation and demand response programs, (4) volatile commodity market prices, and (5) the correlations between fuels. Moreover, because estimates of avoided energy costs are dependent on a number of long-term assumptions that may not play out as anticipated, the risk of forecast error escalates as the forecast period lengthens. Under NC Power's methodology, the ratepayer or QF, as applicable, will bear the financial burden of inaccurate energy forecasts for only a relatively brief two-year period.

NC Power asserted that a formula rate is appropriate as a fixed price rate for QF avoided cost obligations. NC Power submitted that the energy price determination mechanism exemplified by Section VI of its Schedule 19-DRR is such a fixed formula rate.

Finally, NC Power argued that, should the Commission decide that fixed energy rates are required by PURPA, the Commission should not implement that decision in this proceeding. In support of this position, the Company noted that, when it prepared filings in this proceeding, it did so with the expectation that the Commission would continue its long-standing practice of allowing biennial reset of avoided energy rates. Consequently, NC Power did not prepare any long-term energy rate estimates other than rates for projects rated at 100 kW or less. Further, NC Power has not made any determination whether the DRR method would be the appropriate method to calculate long-term fixed avoided cost energy rates for QFs larger than 100 kW. Because of the risk to ratepayers and QFs discussed above, NC Power asserted that these are not decisions that should be made in haste. Moreover, NC Power argued that there is no evidence that its current method of calculating avoided energy costs has discouraged QF development in North Carolina. Accordingly, if the Commission should decide that fixed energy rates are required by PURPA, NC Power urged the Commission to implement that decision starting with the next biennial proceeding. Such a ruling would give NC Power and all other stakeholders time to make a thoroughly thought out and deliberate decision on the appropriate method for calculating long-term fixed energy rates and related issues, including the appropriate contract term given the increased risk to ratepayers.

In its proposed order, the Public Staff stated that a rate that is reset every two years clearly does not qualify as either a fixed rate or as a fixed formula rate. In addition, the Public Staff noted that the FERC's language quoted by NC Power, on page 10 of its reply comments, clearly indicates that the legally enforceable obligation option requires that avoided cost rates be established in advance of the purchase. The petitioner in the arbitration proceeding in Docket No. SP-467, Sub 1, Economic Power and Steam Generation, LLC, clearly indicated that it cannot obtain financing if only the currently approved reset for changes in fuel prices was offered. There is no reason to think that the QFs entitled to the standard contracts would not encounter the same difficulties. The Public Staff concluded that the Commission should require NC Power to file in the next avoided cost proceeding fixed avoided energy rates for five-year, ten-year and 15-year periods for QFs entitled to standard contracts.

Based upon the foregoing, the Commission concludes that NC Power should continue to be required to offer Schedule 19-DRR in addition to its proposed Schedule 19-LMP, subject to the conditions approved in the 2006 avoided cost proceeding, as detailed in the Commission's Order issued on December 19, 2007, in Docket No. E-100, Sub 106. With respect to the reset of avoided energy rates, the Commission agrees with the position of the Public Staff. The Commission also agrees that the required fixed energy rates should be implemented starting with the next biennial proceeding. Therefore, NC Power should be required to file in the next avoided cost proceeding proposed fixed long-term, levelized avoided energy rates for QFs entitled to standard contracts.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 6

No party to this proceeding recommended a change with respect to the rates to be made available to QFs not eligible for the standard long-term levelized rates. The Commission concludes that PEC, Duke, and NC Power should continue to be required to offer QFs not eligible for the standard long-term levelized rates the option of contracts and rates derived by free and open negotiations or, when explicitly approved by Commission Order, participation in the utility's competitive bidding process for obtaining additional capacity. The QF also has the right to sell its energy on an "as available" basis pursuant to the methodology approved by the Commission. Under PURPA, a larger QF is just as entitled to full avoided costs as a smaller QF. The exclusion of larger QFs from the long-term levelized rates in the standard rate schedules was never intended to suggest otherwise.

The Commission has previously ruled that, absent an approved, active solicitation, negotiations between a utility and a larger QF are subject to arbitration by the Commission at the request of either the utility or the QF to determine the utility's actual avoided cost, including both capacity and energy components, as appropriate, as long as the QF is willing to commit its capacity for a period of at least two years. Such arbitration would be less time consuming and expensive for the QF than the previously available complaint process. The Commission concludes that the arbitration option should be preserved.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The Commission has repeatedly affirmed that the peaker method is appropriate for calculating Duke's and PEC's avoided cost rates and the DRR method is appropriate for calculating NC Power's avoided cost rates. No party to this proceeding challenged the appropriateness of these methodologies. For purposes of this proceeding, the Commission concludes that the peaker method and the DRR method are generally accepted and used by the electric utility industry and are reasonable for use in this proceeding. As is its practice, the Commission will address alternative methodologies if and when they are proposed in future avoided cost proceedings.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The Commission has traditionally used a PAF in calculating avoided capacity cost rates for utilities that use the peaker methodology. This adjustment takes into account the fact that a generating facility cannot be in operation at all times. A wholesale power contract typically includes a capacity charge that is calculated on a per-kW basis and is payable regardless of the number of kWh the seller provides. In contrast, the standardized capacity rates for purchases from QFs in North Carolina are calculated on a per-kWh basis. As a result, if rates were set at a level equal to a utility's avoided capacity costs without a PAF, a QF would not receive the full capacity payment to which it is entitled unless it operated 100% of the on-peak hours throughout the year. The PAF is used to increase the capacity rates and, thus, allow a QF to experience a reasonable number of outages and still receive payments equal to the utility's avoided capacity costs. Until the 1996 avoided cost proceeding in Docket No. E-100, Sub 79, the Commission approved a PAF of 1.2 for the calculation of avoided cost rates for all QFs. In its Order approving avoided cost rates in that docket, the Commission approved a PAF of 2.0 for hydro QFs with no storage capability and no other type of generation, which allows such QFs to recover their full capacity payments if they operate 50% of the on-peak hours. The 1.2 PAF used by the Commission in previous cases (for QFs other than run-of-the-river hydro facilities) reflected the Commission's judgment that, if a unit is available 83% of the time, it is operating in a reasonable manner and should be allowed to recover the utility's full avoided costs.

No party to this proceeding proposed any changes to the approved PAFs. Accordingly, the Commission concludes that a PAF of 2.0 should be utilized by PEC and Duke in their respective avoided capacity cost calculations for hydroelectric facilities with no storage capability and no other type of generation and that a PAF of 1.2 should be used for all other QFs.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The Public Staff, in its initial statement, discussed its position that PEC's exclusion of start costs in the calculation of its avoided energy costs and rates was not consistent with PURPA. Noting its discussion of this issue in its filings in the EPCOR/PEC arbitration case in Docket No. E-2, Sub 966, the Public Staff argued that PURPA requires the inclusion of the start costs included in the Total System Cost output from PROSYM in the calculation of on-peak and off-peak marginal energy costs. In this regard, the Public Staff requested the Commission to order PEC to refile its avoided energy rates calculated in this manner. In its reply comments, PEC stated that, after a careful review of the Public Staff's recommendation, it agreed to refile its avoided energy costs using the PROSYM Total System Cost output, which includes start costs. PEC filed Revised Attachments 1 and 2 and Revised Exhibits 2 and 3 and requested that the Commission approve the revised avoided energy rates contained in its revised Rate Schedule CSP-27. The Commission concludes that PEC's avoided energy costs should be calculated using the PROSYM Total System Cost output data, which includes start costs.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 10

In its initial statement, the Public Staff discussed its concerns about the fact that both Duke and NC Power have provisions that make the currently approved avoided cost rates unavailable as of the expected due date for the utilities' filing of proposed new rates in the next biennial avoided cost proceeding. This mechanism replaced the Commission's previous practice of allowing a utility to file a motion to suspend the availability of the currently approved avoided cost rates and tariff, with QFs that had their certificates of public convenience and necessity (CPCNs) as of the date of the motion being entitled to the existing rates. QFs that did not yet have their CPCNs and signed contracts at the new, proposed rates were entitled to have their payments increased if the Commission approved avoided cost rates higher than the rates proposed by the utilities (without being subject to such rates being decreased if lower rates were approved). Given the Commission's recent interpretation of the FERC's regulations in two arbitration proceedings, EPCOR USA North Carolina LLC v. Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc., in Docket No. E-2, Sub 966 (EPCOR), and Economic Power & Steam Generation, LLC v. Virginia Electric and Power Company, d/b/a Dominion North Carolina Power, in Docket No. SP-467 (EP&S), Sub 1, the Public Staff questioned whether it is consistent with PURPA to end the availability of approved avoided cost rates as of the date new proposed avoided costs rates are expected to be filed.

In its proposed order, the Public Staff stated that it was not sufficient for only variable rates to be made available during the interim between filing and approval of new avoided cost rates given the Commission's interpretation of PURPA in the arbitration proceedings. Because the Commission has decided that QFs that meet certain eligibility requirements are entitled to long-term, levelized avoided cost rates, those QFs cannot be deprived of such options during the pendency of the avoided cost proceeding. The Public Staff concluded that the Commission should return to its previously established policy of the proposed avoided cost rates being available, subject to being increased if the Commission approved higher avoided costs, to QFs that are otherwise eligible to enter into standard contracts between the filing of (not the pre-established due date for) proposed new avoided cost rates and the Commission's approval of new avoided cost rates.

NC Power

According to NC Power, its proposed Schedule 19-DRR is available to any size-eligible QF with a CPCN, if a CPCN is required by the Commission, that enters into a contract and begins deliveries of power on or prior to December 31, 2012 (the Availability Deadline). The Company explained that December 31, 2012, is the Availability Deadline because that is the end of the two-year period forming the basis for the estimated avoided cost rates contained in Schedule 19-DRR (Biennial Period). Thus, a QF that will not begin delivery of power during the Biennial Period (a Non-Period QF) is not eligible for the Schedule 19-DRR rates approved during this proceeding.

NC Power's existing policy with respect to Non-Period QFs is to enter into contracts with such QFs at the rates, terms, and conditions contained in the then-proposed Schedule 19-DRR that covers the applicable Biennial Period, subject to true-up based on the Commission's final order in such biennial proceeding. Applying this policy to the currently proposed Schedule 19-DRR, during the interval between January 1, 2011, and the Commission's order in this proceeding, the Company will enter into contracts with QFs that can meet the Availability Deadline at the rates, terms, and conditions contained in its proposed Schedule 19-DRR. The rates and contract terms would be trued-up to reflect any increase in the rates approved in the Commission's final order in this proceeding. The Company will enter into contracts with Non-Period QFs that cannot meet the Availability Deadline in this proceeding at the rates, terms, and conditions contained in the Schedule 19-DRR as proposed in the biennial proceeding for the future applicable period. NC Power is willing to memorialize its existing policy in Schedule 19-DRR if desired by the Commission.

In its initial statement, the Public Staff questioned whether Schedule 19-DRR's availability limitation was consistent with PURPA in light of recent Commission orders in Docket Nos. E-2, Sub 966 and SP-467, Sub 1. In those orders, which involved QFs that were not eligible for standard rates, the Commission interpreted Section 292.304(d) of FERC's regulations implementing PURPA and held that this regulation gives a QF two options: (a) to sell power "as available," or (b) to sell pursuant to a legally enforceable obligation (LEO) over a specified term. If the QF chooses the LEO option, the QF has the further option of choosing rates based upon avoided costs calculated at the time the LEO is incurred or at the time the power is delivered. Based on its interpretation of these Commission orders, the Public Staff asserted, in effect, that the application of the Availability Deadline to Non-Period QFs is inconsistent with PURPA "when that QF has its CPCN, is eligible for the standard rates, and has indicated that it intends to commit itself." According to NC Power, the Public Staff suggested that if the Commission concludes otherwise, then "at a minimum, the QF qualifying for the standard rates should be entitled to the proposed avoided cost rates, subject to those rates being trued-up if the Commission approved higher rates."

NC Power agreed, as discussed above, that that Non-Period QFs should be entitled to the then-proposed avoided cost rates, subject to being trued-up based on the Commission's final order in a biennial proceeding. NC Power disagrees that the Availability Deadline is inconsistent with PURPA and that Section 292.304(d) should apply in a standard rate context.

NC Power noted that avoided costs determined in the Commission's biennial proceedings are necessarily based on the assumption that QFs will begin power deliveries during the Biennial Period. For example, in this proceeding, NC Power's Schedule 19-DRR rates are all based on the assumption that a QF will start delivering power to the utility in either 2011 or 2012. Accordingly, the avoided capacity rates start in 2011 or 2012, as applicable, and run for five, ten, or 15 years from 2011 or 2012, as applicable. Similarly, with respect to 100 kW or smaller QFs, for which fixed avoided cost energy rates are required, avoided cost energy rates start in 2011 or 2012, as applicable, and run for five, ten, or 15 years from 2011 or 2012, as applicable. There will be no avoided cost rate estimates developed or approved in this proceeding for QFs that begin operating in 2013, 2014, and beyond. Thus, new avoided cost estimates would need to be calculated for the Non-Period QF for years not covered by the Schedule 19-DRR approved in this proceeding using different data and assumptions from those used in the Schedule 19-DRR approved in this proceeding.

NC Power also argued that Section 292.304(d) of the FERC's regulations does not apply in the standard rate context. The Company noted that Schedule 19-DRR is a standard rate approved by the Commission pursuant to its obligation under 18 C.F.R. 292.204(c)(1) to put standard rates into effect for QFs with a design capacity of 100 kW or less. As permitted by 18 C.F.R. 292.304(c)(2), the Commission has expanded standard rates to apply to QFs of 5 MW or less. Standard rates adopted by the Commission are required to be "consistent with paragraphs (a) and (e) of 18 C.F.R. 292.304." In short, according to the Company, Section 292.304(d) is not applicable to Commission-approved standard rates. Moreover, the Company asserted that, even if the Commission were to find Section 292.304(d) applicable in a standard rate context, such a holding would not achieve the result advocated by the Public Staff (i.e., entitling Non-Period QFs to currently-effective Schedule 19-DRR rates).

NC Power noted that Section 292.304(d) provides a QF with the right:

> (1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or
>
> (2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:
>
> (i) The avoided costs calculated at the time of delivery; or
> (ii) The avoided costs calculated at the time the obligation is incurred.

NC Power stated that the meaning of subsection (d)(2) was at issue in the EPCOR[1] and EP&S proceedings. In its January 26, 2011 Order on Arbitration regarding EP&S (EP&S Order), the Commission held that, under the specific facts of that case, a QF established an LEO in November 2009 because at that time the QF had (1) obtained a CPCN, and (2) made clear to the purchasing utility that it wanted to sell its output. Having established an LEO, the Commission further held that the QF was entitled to avoided cost payments "based upon forecasts using data as of the time the LEO is incurred" (i.e., November 2009).

[1] NC Power's analysis focused on the EP&S proceeding because it involved an unconstructed QF. The EPCOR proceeding involved two already-constructed and operating QFs. It is entirely within the control of already-operating QFs that meet the other eligibility requirements for Schedule 19-DRR to meet the Availability Deadline.

Thus, under the plain language of 18 C.F.R. 292.304(d)(2)(ii) and consistent with the Commission's rulings in the EP&S proceeding, argued NC Power, a Non-Period QF invoking 18 C.F.R. 292.304(d)(2) would not be entitled to the currently effective Schedule 19-DRR. Instead, that QF would be entitled to avoided costs calculated at the time the obligation is incurred and based upon forecasts using data as of the time the LEO is incurred. For example, a Non-Period QF that established an LEO in October 2012 for a facility that would begin delivering power in December 2014 would not be entitled to avoided cost rates approved in this proceeding, but rather avoided cost calculated at the time of the LEO. Further, such avoided cost estimates would be based upon forecasts using data available in October 2012, not forecasts based on the data used in this proceeding. NC Power argued that, in short, there would be potentially endless rounds of calculations of avoided costs as of each QF's LEO, which would defeat the whole purpose of establishing standard rates. In sum, NC Power argued that artificially grafting 18 C.F.R. 292.304(d) onto the standard rate context would not entitle a QF to the currently-approved standard rates, and would embroil the Commission and the relevant utility into myriad individual rate setting proceedings. This result would entirely contradict the rationale for standard rate options, which is to allow small QFs, and utilities, to avoid the transactional cost of individual rate estimates and contract negotiations.

Based on the record in this proceeding, the Commission agrees with NC Power that limiting the availability of Schedule 19-DRR rates to QFs that can deliver power during the Biennial Period is reasonable, consistent with PURPA and Commission orders implementing PURPA, and should continue to be approved. In addition, the Commission concludes that NC Power's policy with respect to Non-Period QFs is reasonable.

Duke

In its initial and revised initial statements, Duke stated that its proposed Schedules PP(H) and PP(N) update the Capacity Credits and Energy Credits to reflect the most recent projections of Duke's avoided capacity and energy costs. To make standard rates available to QFs during the time that the next proceeding is pending, while still recognizing that new rates will be based on more current avoided cost projections, Schedules PP(N) and PP(H) reflect that the fixed long-term rates will be available only to customers under contract with the Company on or before November 1, 2012, and the variable rates will remain available until new fixed long-term rates are approved. Citing the Commission's 2007 avoided cost Order, Duke noted that the Commission had previously approved inclusion of this provision in that biennial cost proceeding.

In its reply comments, Duke recounted the procedural history of its proposal in Schedules PP(H) and PP(N). In the 1994 avoided cost proceeding, Docket No. E-100, Sub 74, the Commission allowed a utility to file a motion to suspend the availability of its currently approved cost rates and tariff. QFs that had their CPCNs as of the date of the motion were entitled, however, to the existing rates. QFs without CPCNs that signed contracts at the new, proposed rates were entitled to have their payments increased if the Commission approved avoided cost rates higher than the rates proposed by the utilities. If the Commission approved lower rates, however, the Commission would not permit the utilities to decrease the payments to the QFs.

In the 1996 avoided cost proceeding, Docket No. E-100, Sub 79, the Company requested that the Schedule PP rates be available only to QFs entering contracts on or before the 1998 due date for the next biennial proceeding, for delivery on or before May 4, 2001. The Company argued that allowing its request would better ensure that the avoided costs rates reflect current avoided costs, noting that even with that time limitation, nearly four years could elapse from the time that avoided costs were estimated until delivery begins. The Commission approved the Company's request by Order issued June 19, 1997. Therefore, until 2007, the availability of Schedule PP expired upon the filing of new proposed avoided cost rates in the next biennial proceedings.

In the 2006 avoided cost proceeding, Docket No. E-100, Sub 106, however, the Company requested to modify the expiration of Schedule PP. To make standard rates available to QFs during the time the next biennial proceeding was pending, while recognizing that the new rates would be based upon more current avoided cost projections, Duke proposed that the fixed long-term rates be available only to customers under contract with the Company on or before November 1, 2008, and that the variable rates remain available until new fixed long-term rates were approved.

The Company proposes to do the same for the next biennial proceeding. The proposed provision reads as follows:

> The Fixed Long-Term Rates on this Schedule are available only to Customers under contract with the Company on or before November 1, 2012 for delivery of power beginning on or before the earlier of thirty (30) months from the date of execution of the contract or May 1, 2015.

According to Duke, this provision makes standard rates available to QFs during the time the next proceeding is pending, while recognizing that the new rates will be based upon more current avoided cost projections. In other words, Duke proposes to continue its currently approved procedure of making its variable rates that are approved by the Commission in this proceeding available to QFs until the Commission approves new fixed long-term rates in the next biennial proceeding. Furthermore, customers that execute contracts containing the variable rates after expiration of the long-term rates on Schedules PP(N) and PP(H) may then amend their contracts to select one of the long-term rates for which they are eligible, once new avoided cost rates are approved by the Commission.

Duke noted that its experience has shown that a utility's filing to lower its avoided cost rates sometimes prompts QFs to try to "lock in" at the current higher rates before the Commission acts. Duke's provision, however, allows for long-term avoided costs rates offered to the QFs to more closely align to actual avoided costs, instead of simply providing a potential for QFs seeking to enter into contracts after November 1, 2012, to "game" the system.

According to Duke, the Commission's conclusions in the recent arbitrations do not require Duke to make available its fixed long-term rates that were calculated prior to November 2010 to QFs seeking a contract after November 1, 2012. Instead, PURPA and the regulations promulgated from it require the avoided costs rates for purchases by electric utilities "shall be just and reasonable to the electric consumers of the electric utility and in the public interest" and shall not exceed the utilities' avoided costs. PURPA 210(b); 18 C.F.R. 292.304(a). Duke stated that, if a QF seeks a contract with Duke after November 1, 2012, the QF may obtain the variable rates approved in this docket that will be in effect until the Commission approves the Company's proposed, calculated avoided cost rates, including fixed long-term rates, in the next biennial proceeding. After that determination is made, the QF may amend its contract to opt into the approved, long-term rates for which it is eligible. Duke argued that this prevents exposing the utility and the ratepayers to paying for longer periods of time avoided costs rates that are in excess of the utility's actual avoided costs. According to Duke, Exhibit 6 to Duke's initial statement shows that most of the Company's PPAs with QFs are at variable rates, and, therefore, the Company's provision also better reflects its experience with QFs in this respect.

The Commission notes that in its Order in the 2006 avoided cost proceeding, it offered the following discussion and conclusions regarding this issue:

> In Docket No. E-100, Sub 79, and subsequent avoided cost proceedings, the Commission has authorized Duke to include in Rate Schedules PP(H) and PP(N) language under which the rates provided therein will be available only to customers under contract with the company on the date of its next biennial avoided cost filing. (In the existing schedules approved for Duke by the Commission in 2005, that date is November 1, 2006.) This language was added to prevent QFs from gaming the system by taking advantage of differences between the existing rates and the proposed rates for the following biennium. The result is that, during the period between the filing of proposed new avoided cost rates and the Commission's order ruling on those rates, Duke is unable to enter into long-term contracts with QFs at standard rates and is also unable to purchase energy from QFs at variable rates. In its initial statement in this proceeding, Duke proposed to modify Rate Schedules PP(H) and PP(N) so that the long-term rates provided in the schedules will still be available only to QFs under contract with the company on November 1, 2008 (the date of the next avoided cost filing), but variable rates for energy purchases will remain available until new variable rates are approved. If a QF enters into a contract for sales under variable rates during the period between November 1, 2008 and the issuance of the Commission's order ruling on the proposed rates, the QF

will have the option of converting to any of the newly approved long-term rates once the Commission's order is issued or, if the QF elects to remain on variable rates, the previously existing variable rates will be superseded by the newly approved ones. Neither the Public Staff nor any other party objected to this modification to Rate Schedules PP(H) and PP(N) and the Commission finds that is it reasonable and should be approved.

The Commission continues to agree with the arguments put forth by Duke and the reasoning stated in the Commission's decision in the 2006 avoided cost proceeding and concludes that Duke's current treatment of this issue remains reasonable.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 11

PEC argued that the applicable federal laws and regulations require the Commission to balance the dual and competing interests of encouraging QFs and its duty to ensure that a utility's avoided cost rates are just and reasonable to the electric utility's customers and are in the public interest. 18 C.F.R. 292.304(a). To achieve such a balance, PEC recommended that the Commission establish a viability prerequisite as a condition for determining the date of an LEO. The viability prerequisite would require that a QF be ready, willing, and able to enter into a contract within 12 months of any LEO. PEC claimed that this would ensure that QFs are not allowed to unfairly lock in higher rates to the detriment of the utility's customers.

According to the Public Staff, this would require a QF to make a very substantial showing that could include, among other things, its net worth, the number of its employees, whether all necessary permits and approvals had been obtained, whether the QF had engaged consultants, and whether the QF had consulted with lending institutions. In its proposed order, the Public Staff argued that the Commission had previously rejected requiring more information than required by the CPCN application process and should continue to reject such requirements in the context of when an LEO has occurred.

PEC explained that, while the determination of the LEO is up to the states, the FERC has stressed that the states are still confined to the requirements of PURPA, which require that "the rates for qualifying facilities shall: (1) be just and reasonable to the electric utility's consumers and in the public interest; and (2) not discriminate against qualifying cogenerators or small power producers." PURPA 210(b); 18 C.F.R. 292.304(a). In considering this provision of PURPA in a case on appeal from the Idaho Public Utilities Commission involving the avoided cost rate to be paid by PacifiCorp to the owner of a 40-MW QF, the Supreme Court of Idaho stated that "a balance must be struck between the local public interest of a utility's electric consumers and the national public interest in development of alternative energy sources." Rosebud Enter., Inc. v. Idaho Pub. Utils. Comm'n, 917 P.2d 766, 770-71 (1996). PEC noted that, in pursuit of this balance, the interpretation of the "just and reasonable" language has spawned brisk debate in many jurisdictions.

PEC explained in its reply comments that, when determining whether an LEO exists in North Carolina, the Commission relies upon (1) the date when the QF committed to sell its generation and (2) the date when the QF had a CPCN. In the EP&S Order, the "commitment to sell" criteria was addressed by the Commission by stating that "[a] 'legally enforceable obligation' does not require a signed contract, but the QF must be ready, willing and able to sign a contract." However, the Commission did not clarify what factors contribute to the determination that a QF is "ready willing and able to sign a contract," or specify any limitation on the pendency of such determination once it is established.

PEC then concluded that, in order to prevent post hoc justifications of when a "commitment to sell" is made, it is appropriate to incorporate a viability criterion into the determination of the date of the LEO to prevent a QF from unfairly locking in avoided cost rates that do not accurately reflect the costs the utility expects to avoid during the period the QF supplies electricity to the utility. According to PEC, this will, in turn, ensure that a "just and reasonable" rate is established consistent with PURPA regulations.

According to PEC, incorporating a viability prerequisite standard will ensure that a utility and its customers will be in the same or similar positions as they would have been were they not required to purchase from the QFs, which is entirely consistent with the Supreme Court's interpretation of the "just and reasonable" standard. Specifically, for purposes of establishing an LEO and the corresponding avoided cost rates, the QF must be ready, willing, and able to enter into a contract within twelve months.

The Public Staff argued that the Commission should not reverse its prior decisions with respect to when an LEO has occurred based upon reply comments by one party.

The Commission concludes that it would be inappropriate to revisit in this proceeding the Commission's prior decisions as to when an LEO has occurred. The issue in this proceeding is the availability of standard contracts and long-term levelized rates to specified QFs contracting to sell 5 MW or less. It would be entirely inappropriate to require such small QFs to meet the higher standard proposed by PEC, and they certainly should not be required to meet a higher standard than the larger QFs in the arbitration proceedings were required to meet. Accordingly, PEC's proposed incorporation of a viability prerequisite for QFs into the current framework is rejected.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The fifth paragraph of NC Power's Schedule 19-DRR PPA deals with a situation in which a regulatory body with jurisdiction, such as this Commission, the Virginia State Corporation Commission (VSCC), or FERC issues an order (a Regulatory Order) that (1) prohibits rate recovery of payments made to a QF, and/or (2) requires NC Power to refund to its ratepayers payments already made to a QF (the Regulatory Disallowance Clause). In the event of such a Regulatory Order, the Regulatory Disallowance Clause provides that rates under the PPA will be reset on a prospective basis at the levels that

NC Power is allowed to recover in rates. Further, if a Regulatory Order requires NC Power to refund to ratepayers previous payments to a QF, then the QF is similarly required to refund to NC Power those amounts. The Commission has approved standard Schedule 19-DRR PPAs containing clauses similar to the Regulatory Disallowance Clause at least since the 1996 avoided cost proceeding in Docket No. E-100, Sub 79.

The Public Staff, in its initial statement, stated that, given that a standard agreement for renewable QFs contracting to sell 5 MW or less is all that is involved, such a provision seemed unwarranted and likely to discourage QF development. In addition, the Public Staff argued that this requirement has the effect of changing the rate paid to the QF because of subsequent regulatory action, which was rejected in 1983 in Docket No. E-100, Sub 41 when language was proposed that would have allowed existing standard contracts to be amended as the result of subsequent governmental or judicial action.

NC Power's position is that the Regulatory Disallowance Clause is warranted and that there is no evidence that the clause has discouraged QF development. NC Power noted that its purchase of energy and capacity from QFs is not optional. Currently, pursuant to PURPA, and the rules, regulations, and orders of this Commission, the VSCC and FERC, NC Power has a mandatory obligation to purchase energy and capacity from QFs of 20 MW or less at the Company's avoided cost, on the theory that the development of QFs provides a societal benefit.

Because NC Power is legally required to purchase energy and capacity from QFs, there should never be, according to NC Power, an order disallowing rate recovery of those QF payments. While the risk of such a disallowance is remote, NC Power noted that the risk is real, and offers as evidence two instances where either this Commission or the VSCC did in fact disallow rate recovery of QF payments. NC Power asserted that there is no principled reason for this remote but real risk to be borne solely by itself or to force it and its shareholders to continue to make uncompensated payments to the QF following a Regulatory Order.

With respect to the Public Staff's assertion that the Regulatory Disallowance Clause is "likely to discourage QF development," NC Power noted that nothing in the record of this proceeding supports that assertion. NC Power also noted, citing, for example, Freehold Cogeneration Assocs. v. Board Of Regulatory Comm'rs of New Jersey, 44 F.3d 1178 (3d. Cir. 1995), that QFs and their lenders know, as does NC Power, that a regulatory disallowance is a remote possibility under existing law and precedent.

Finally, NC Power noted that the Commission has approved standard Schedule 19-DRR PPAs containing a clause similar to the Regulatory Disallowance Clause since at least 1997, which was well after its April 1, 1983 order in Docket No. E-100, Sub 41 raised by the Public Staff.

Based on the record in this proceeding, the Commission finds that NC Power's inclusion of a regulatory disallowance clause in its Schedule 19-DRR is reasonable and should be allowed.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 13

Except as discussed otherwise herein, the rate schedules and standard contract terms and conditions proposed in this proceeding by PEC, Duke, and NC Power were not opposed. They should be approved except as otherwise discussed herein. The utilities should be required to file new versions of their rate schedules and standard contracts, in compliance with this Order, within 20 days after the date of this Order. They should be allowed to go into effect ten days after they have been filed. The utilities' filings should stand unless specific objections as to the accuracy of the calculations and conformity to the decisions herein are filed within that ten-day period.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 14

In the cover letter to its proposed order, the Public Staff indicated that it had begun its investigation of New River's proposed avoided cost rates, as revised, but that the rates as filed presented a number of difficult issues. Given J.D. Wind and the Commission's recent interpretations of PURPA with the FERC cases in mind, the Public Staff indicated that issues also were raised about the appropriateness of WCU's proposed formula rates and lack of long-term rate options. The Public Staff proposed to make a separate filing with respect to the appropriate avoided cost rates and standard contracts for both WCU and New River.

On May 12, 2011, the Public Staff filed a letter in this docket stating that, since filing its proposed order, it has been in communication with counsel for New River, with the consultant for New River and WCU, and with counsel for Duke, which is the requirements supplier at wholesale to Blue Ridge Electric Membership Corporation (Blue Ridge). The Duke/Blue Ridge PPA treats New River's native load as if it were Blue Ridge's native load for purposes of Duke's obligations vis-a-vis Blue Ridge, thus involving Duke and the terms of the Blue Ridge PPA in the discussion.

A complicating factor in the process was the existence of a QF waiting to sign a PPA with New River. New River has since informed the Public Staff that the QF, which is participating in the NC GreenPower program, is willing to proceed under the formula rates as filed. As a result, more time can be taken to resolve the outstanding issues. In its May 12 letter to the Commission, the Public Staff proposed to continue working with the relevant parties and then to make a filing in several months with respect to the appropriate avoided cost rates and standard contracts for both WCU and New River. In the meantime, the Public Staff recommended that the Commission approve WCU's and New River's avoided cost rate schedules, as filed, on an interim basis pending further resolution of the issues described in the Public Staff's proposed order transmittal letter filed April 29, 2011, and further order of the Commission.

Based upon the foregoing, the Commission concludes that the avoided cost rates for WCU and New River, as filed, should be approved on an interim basis pending further order of the Commission.

IT IS, THEREFORE, ORDERED as follows:

1. That PEC shall offer long-term levelized capacity payments and energy payments for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell 5 MW or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years shall include a condition making contracts under those options renewable for subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other relevant factors or (2) set by arbitration. PEC shall offer its standard five-year levelized rate option to all other qualifying facilities contracting to sell 3 MW or less capacity.

2. That Duke shall offer long-term levelized capacity payments and energy payments for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell 5 MW or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years shall include a condition making contracts under those options renewable for subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other relevant factors or (2) set by arbitration. Duke shall offer its standard five-year levelized rate option to all other qualifying facilities contracting to sell 3 MW or less capacity.

3. That NC Power shall offer long-term levelized capacity payments and energy payments calculated pursuant to the DRR method based on long-term levelized generation mixes with adjustable fuel prices for five-year, ten-year and 15-year periods as standard options to (a) hydroelectric qualifying facilities owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell 5 MW or less capacity and (b) non-hydroelectric qualifying facilities fueled by trash or methane derived from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell 5 MW or less capacity. The standard levelized rate options of ten and 15 years shall include a condition making contracts under those options renewable for subsequent terms at the option of the utility on substantially the same terms and provisions and at a rate either (1) mutually agreed upon by the parties negotiating in good faith and taking into consideration the utility's then avoided cost rates and other

relevant factors or (2) set by arbitration. The standard five-year levelized rate option shall be offered to all other qualifying facilities contracting to sell 3 MW or less capacity. Long-term levelized energy payments should be offered as an additional option for small qualifying facilities rated at 100 kW or less capacity.

4. That NC Power may offer, as an alternative to avoided cost rates derived using the DRR method, avoided cost rates based upon market clearing prices derived from the markets operated by PJM, subject to the following conditions: (a) any QF choosing to enter into a contract using the PJM market pricing method shall be allowed to terminate its existing Schedule 19-LMP contract without paying termination charges after the first year upon 90 days prior written notice, and, after doing so, enter into a new two-, five-, ten-, or 15-year Schedule 19-DRR contract, at its option, and (b) NC Power shall calculate avoided cost payments using each method on a monthly basis for the next two years and provide the comparison to each QF in North Carolina that is receiving payment under either of the two rate schedules approved in this Order at least once every six months, with the first report due no later than eight months from the QF's contract date. NC Power shall file these comparisons with the Commission in this docket at the time they are provided to the QFs.

5. That NC Power shall provide a comparison of the DRR method and the PJM market pricing method in the next biennial avoided cost proceeding. As part of this comparison, NC Power shall (a) file PJM prices during each relevant summer season; (b) identify the five peak hours that were used in the SPPF; (c) file the PJM input data for each of the five coincident peak hours; and (d) file a comparison of the payments a QF would have received for one year, including the first full summer following the date of this Order, under the DRR method and under the PJM market pricing method, assuming various levels of hypothetical outages during the five coincident peak hours during the preceding summer.

6. That PEC, Duke, and NC Power shall offer QFs not eligible for the standard long-term levelized rates the following three options if the utility has a Commission-recognized active solicitation underway: (1) participating in the utility's competitive bidding process, (2) negotiating a contract and rates with the utility, or (3) selling energy at the utility's Commission-established variable energy rate. If the utility does not have a Commission-recognized active solicitation underway, it shall offer QFs not eligible for the standard long-term levelized rates the options of (1) contracting with the utility to sell power at the variable energy rate established by the Commission in these biennial proceedings or (2) contracting with the utility to sell power at negotiated rates. If the utility does not have a solicitation underway, any unresolved issues arising from such negotiations will be subject to arbitration by the Commission at the request of either the utility or the QF in order to determine the utility's actual avoided cost, including both capacity and energy components, as appropriate; however, the Commission will only arbitrate disputed issues if the QF is prepared to commit its capacity to the utility for a period of at least two years. In either case, whether there is an active solicitation underway or not, QFs not eligible for the standard long-term levelized rates have the option of selling into the wholesale market. The exact points at

which an active solicitation should be regarded as beginning and ending for these purposes shall be determined by motion to, and order of, the Commission. Unless there is such a Commission order, it will be assumed that there is no solicitation underway. If the variable energy rate option is chosen, such rate may not be locked in by a contract term, but shall instead change as determined by the Commission in the next biennial proceeding.

7. That a PAF of 2.0 shall be utilized by both PEC and Duke in their respective avoided cost calculations for hydroelectric facilities with no storage capability and no other type of generation.

8. That a PAF of 1.2 shall be utilized by both PEC and Duke for all QFs that do not qualify for a PAF of 2.0 as set forth above.

9. That PEC's avoided energy costs shall be calculated using the PROSYM Total System Cost output data, which includes start costs.

10. That NC Power's inclusion of a regulatory disallowance clause in its standard contract for purchases of energy and capacity pursuant to Schedule 19-DRR is reasonable and shall continue to be allowed.

11. That contract clauses currently in place by Duke and NC Power that limit the availability of standard long-term contract rates in the time period immediately prior to the approval of new biennial rates are reasonable and shall continue to be allowed.

12. That PEC's proposed incorporation into the current framework of a viability prerequisite for QFs is hereby rejected.

13. That NC Power shall file in the next avoided cost proceeding proposed fixed long-term, levelized avoided energy rates for QFs entitled to standard contracts.

14. That the rate schedules and standard contract terms and conditions proposed in this proceeding by PEC, Duke, and NC Power are hereby approved except as otherwise discussed herein. The utilities shall file new versions of their rate schedules and standard contracts, in compliance with this Order, within 20 days after the date of this Order. Such rate schedules and standard contracts shall go into effect ten days after they have been filed unless specific objections as to the accuracy of the calculations and conformity to the decisions herein are filed within that ten-day period.

15. That the avoided cost rates for WCU and New River, as filed, are approved on an interim basis pending further order of the Commission.

ISSUED BY ORDER OF THE COMMISSION.

This the 27th day of July, 2011.

NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

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