STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH
NCUC Docket No. E-7, Sub 856

In the Matter of
Application of Duke Energy Carolinas, LLC, For Approval of a Solar Photovoltaic Distribution Generation Program and for Approval of the Proposed Method of Recovery of Associated Costs

ATTORNEY GENERAL'S BRIEF

On January 29, 2009, Duke Energy Carolinas, LLC (Duke) filed a motion for reconsideration of the order issued by the Commission in this docket on December 31, 2008, approving Duke's solar project, with conditions. On February 2, 2009, the Commission entered an order scheduling the filing of initial briefs, reply briefs and an oral argument on Duke's motion for reconsideration, which dates were rescheduled by the Commission in an order issued on February 13, 2009.

DUKE'S SOLAR PROJECT

Duke's solar project is part of its compliance with the Senate Bill 3 Renewable Energy and Energy Efficiency Portfolio Standard (REPS). *Pre-Filed Testimony of Ellen T. Ruff*, at 4-6. The REPS includes a requirement that by 2010 at least .02% of a public utility's retail sales be supplied by solar resources. N. C. Gen. Stat. § 62-133.8(d) (2008). For Duke, that requirement will be about 11,000 megawatt hours (MWH). *Pre-Filed Testimony of Elise Cox and James McLawhorn*, at 4. A utility's costs of compliance with the REPS are recoverable through an annual rate rider. G. S. § 62-133.8(h).

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Duke's project involves placing solar arrays of various sizes on residential, commercial and industrial roof tops in several regions of Duke's North Carolina service area. Duke will pay the roof top owners for use of their space under a lease for the useful life of the equipment, which is about 25 years. The electricity will go to the grid to serve all customers. Duke reduced the project from its original capacity of 20 megawatts (MW) to 10 MW at the suggestion of the Public Staff and other intervenors. The estimated cost of the project is $50 million. However, that cost can be substantially reduced by a 30% federal investment tax credit. *Pre-Filed Rebuttal Testimony of Owen A. Smith*, at 16.

Before deciding on the self-build option, Duke issued a RFP for bids from other companies to supply solar energy. Duke accepted the lowest bid by SunEdison and entered into a contract with SunEdison for the purchase of solar energy and renewable energy certificates to meet part of Duke's REPS requirements. *See Order Granting Certificate of Public Convenience and Necessity with Conditions*, at 4.

The third lowest bid received by Duke was from a new company (hereinafter "Company X") that proposed to build a 20 MW project, consisting of one or more sites of pole mounted solar arrays. Company X's bid stated a per MWH cost lower than Duke's per MWH cost for its self-build project. *Testimony of Owen A. Smith*, T Vol. 1, at 150-151.

About 29% of Duke's per MWH cost is attributable to a disadvantage that Duke, as a public utility, has in the manner that it can receive the federal tax credits, as compared to Company X's manner of receiving the tax credits as a private company. *Testimony of Jane McManeus*, T Vol. 2, at 70-72. Duke asserted that the additional difference in Duke's and Company X's per MWH cost is attributable to the differences in the additional data and experience with distributed generation to be gained by Duke having the sites disbursed throughout North Carolina, as well as the benefit of having a mix of ownership models – individuals, private companies and utility owned. *Order Granting Certificate of Public Convenience and Necessity with Conditions*, at 4-5. In addition, Duke believes that the difference in costs would be narrowed further if Company X reduced the size of its project from 20 MW to 10 MW, as Duke has done.

THE COMMISSION'S ORDER

Duke sought recovery of all the costs of its solar project through the annual REPS rider. However, the Commission's order issued on December 31, 2008, limited the amount of project costs that Duke can recover through the REPS rider to the per MWH cost stated in Company X's bid. The Commission reasoned that REPS compliance was the sole purpose of the annual REPS rider and, therefore, cost recovery through the rider should be limited strictly to that purpose. The Commission rejected Duke's position that the tax treatment difference and the additional data and experience with distributed generation under Duke's project were a part of REPS compliance. However, the Commission did not rule that these aspects of Duke's project costs were imprudent or will result in unreasonable costs. Rather, the Commission stated:

> [D]uke 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 N. C. Gen. Stat. § 62-133.8(h)(1)(a).
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> ...
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> [I]t is important to emphasize that the Commission has given no consideration to disallowing any of the costs of Duke's program for imprudence.

Order Granting Certificate of Public Convenience and Necessity with Conditions, at 16.

Thus, the Commission's order left open the possibility that Duke can prove the costs of the tax treatment and other unique aspects of its project to be prudent and reasonable costs and recover them either as REPS research and development costs, limited to $1 million per year, under N. C. Gen. Stat. § 62-133.8(h)(1)(b), or in a general rate case.

DUKE'S MOTION

Duke's motion for reconsideration is based mainly on the uncertainty that Duke believes the Commission's order creates with regard to Duke's recovery of the federal tax credits for the project. In essence, Duke states that IRS regulations require Duke to spread the tax credits over the 25-year life of the project and to support its annual claim for the tax credits with a finding by the Commission that all project costs were prudent and reasonable. *See Duke Energy Carolinas, LLC's Motion for Reconsideration*, at 6-7.

For example, if the total tax credit is $15 million (30% of the $50 million cost of the project), then Duke might charge ratepayers $600,000 ($15 million ÷ 25 years) less than Duke's annual costs, and plan to recoup that $600,000 each year as a tax credit. However, if in a subsequent REPS rider application or general rate case the Commission ruled that Duke's expenditure of that $600,000 was not prudent or reasonable, it is the opinion of Duke's tax experts that the IRS would disallow the tax credit. *Id.* Thus, Duke would have expended the $600,000 on the project, but not be able to recover it from ratepayers or as a federal tax credit.

To remedy this situation, Duke's motion requests that the Commission either: (1) declare that Duke's pursuit of the project is prudent and reasonable even though the tax credits it will receive do not lower the cost of Duke's project as much as they would lower the cost of Company X's project; or (2) delay Duke's solar REPS requirement until 2011. *Id.* at 17-18.

ARGUMENT

THE PRUDENCE AND REASONABLENESS OF FUTURE COSTS TO BE RECOVERED IN FUTURE ANNUAL RIDER OR GENERAL RATEMAKING PROCEEDINGS IS NOT A PROPER SUBJECT FOR A DECLARATORY RULING.

Pursuant to N.C. Gen. Stat. § 62-60 (2008), "the Commission shall be deemed to exercise functions judicial in nature and shall have all the powers and jurisdiction of a court of general jurisdiction as to all subjects over which the Commission has or may hereafter be given jurisdiction by law." Under N.C. Gen. Stat. § 1-253, *et seq.*, the Declaratory Judgment Act, courts of general jurisdiction are empowered to "declare the rights, status, and other legal relations," of parties that present the court with a justiciable controversy. Thus, as a general proposition, the Commission has the legal authority to make declaratory rulings.

The Commission's primary responsibility is to regulate public utilities to ensure safe, reliable service at just and reasonable rates. N.C. Gen. Stat. §§ 62-30, 62-32, 62-110.1 and 62-131 (2008). Thus, to the extent that the Commission determines that a declaratory ruling in this proceeding would enhance its ability to regulate Duke and Duke's ability to serve its customers, then the Commission could issue a declaratory ruling.

However, Duke has not spent any money building this solar project and it has not benefited from any of the distributed generation data and experience that it anticipates will make its project more valuable than that of Company X. Therefore, it would be premature, and essentially impossible, for the Commission to decide whether the costs for those program attributes will be prudent and reasonable. Further, the reasonableness and prudence of costs incurred to generate electricity for service to ratepayers are matters to be decided in a general rate case, where the Commission knows the activities in which the utility has engaged and the actual cost of those activities, rather than attempting to assess the prudence of future activities and reasonableness of potential costs. N. C. Gen. Stat. § 62-133 (2008).

In addition, the precedential value of such a declaratory ruling is questionable. As the Commission held in Duke's application for a declaratory ruling on its proposed affiliate contracts creating a revolving credit facility, a proceeding for a declaratory ruling is not appropriate where a different process is required by statute.

> [T]he Commission does not believe that this is an appropriate proceeding for a declaratory ruling. These affiliate contracts must be filed with the Commission pursuant to G.S. 62-153(a), and a declaratory ruling should not be used as a substitute for another proceeding required by statute. Anticipatory rulings are not favored, and the Commission does not believe that it is appropriate to issue a declaratory ruling as to how the Commission will rule in a future proceeding. If the declaratory ruling requested herein actually commits the Commission, it would render the future statutory proceeding pointless; if the ruling does not commit the Commission, it fails to give Duke Energy the assurance that it says it needs.

Order on Affiliate Contracts, NCUC Docket No. E-7, Sub 728, at 4-5 (Aug. 2003).

In 2007, the Commission 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 plant. Rejecting specific statements proposed by Duke to define approved "development work," but issuing a general declaration, the Commission stated:

> [t]hese general statements are clearly sufficient to provide Duke with the assurance it needs to continue pursuing the assessment of the proposed Lee Nuclear Station as a potential resource for serving its customers. In

> addition, they are also consistent with the Commission's existing legal authority to provide such assurances. The absence of an evidentiary record mitigates against and precludes the Commission from making a more detailed pronouncement or ruling to define the term "Development Work" at this time.

Order Issuing Declaratory Ruling, Docket No. E-7, Sub 819, at 23 (March 20, 2007).

The Commission need not get entangled in a debate over the prudence and reasonableness of future activities and costs. Rather, the Commission should decline to issue a declaratory ruling and, instead, wait until these questions can be addressed in an appropriate proceeding.

Further, it appears that Duke's desire for a declaratory ruling on the prudence and reasonableness of its solar project activities and costs might be met under N. C. Gen. Stat. § 62-110.1(f) and (f1) (2008), provisions added by Senate Bill 3. Under these subsections, a utility that has received a certificate of public convenience and necessity to construct generating facilities, as Duke received in the present case, must submit an annual progress report, including any revisions to its original project cost estimate. In addition, the utility can request an annual review of the project construction, including a declaration by the Commission that the costs incurred thus far are prudent and reasonable. If the Commission finds that the costs expended have been prudent and reasonable, then those costs are deemed recoverable in the utility's next general rate case, without further review. There is an exception that allows a party to challenge the costs with evidence that the Commission's earlier ruling was erroneous, if the evidence could not have been discovered at an earlier time.

The boundaries of this "rolling prudence review" are untested, but it appears that it could meet Duke's need for an assurance that the non-REPS aspects of its solar project are reasonable and prudent. Further, once the Commission has made one or two such prudence determinations regarding the non-REPS aspects of Duke's project, it would seem that such a precedent would provide the assurance needed by Duke without the need to repeat the procedure annually, at least so long as the activities and costs remain essentially the same.

CONCLUSION

For the reasons stated herein, the Commission should decline to issue a declaratory ruling on the prudence of future activities and the reasonableness of future costs involved in Duke's solar project. Further, the Commission should not grant Duke an extension on the date of its solar REPS requirement.

This the 4th day of March, 2009.

ROY COOPER
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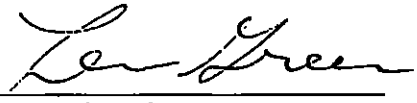
CERTIFICATE OF SERVICE

The undersigned certifies that he has served a copy of the foregoing ATTORNEY GENERAL'S BRIEF upon the parties of record in this proceeding or their attorneys by email and by depositing a copy of the same in the United States Mail, postage prepaid and properly addressed.

This the 4th day of March, 2009.



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