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N.C. Utilities Commission

March 4, 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 Initial Brief in Support of its Motion for Reconsideration in the above referenced docket.

Clerk
Full Commission

Sincerely,

Robert W. Kaylor

Robert W. Kaylor

Enclosures

cc: Parties of Record

Desk

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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 INITIAL 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* and subsequent *Order Granting Motion to Reschedule* in this docket, Duke Energy Carolinas submits this Initial Brief in Support of its Motion.

ARGUMENT

I. If the Company Moves Forward with the Program Pursuant to the Order, It Will Take On a Significant Risk of Violating the Federal Tax Normalization Requirements Which Would Result in the Imposition of Severe Penalties.

The Order largely granted the Company's request with regard to its application for a Certificate of Public Convenience and Necessity ("CPCN"). On the other hand, it significantly modified the Company's cost recovery proposal. Approximately 9 of the 14 pages discussing the evidence and conclusions in support of the various findings of fact addressed cost recovery issues.

Although there is certainly nothing novel about controversies over cost recovery in regulatory proceedings, the end result of the proceeding in this regard is, in Duke Energy Carolinas' experience, unique - and highly problematic. The Order establishes a cost recovery architecture that, in conjunction with its supporting rationale, is pre-disposed to violate the tax normalization rules. It constructs a highly visible "trip wire" which, if triggered, will visit a costly and damaging penalty upon both the Company and its customers.

The workings of the tax normalization rules are undoubtedly complex and, in some ways, highly esoteric; however, the impact of their violation could not be more concrete. Duke Energy Carolinas calculates the likely investment tax credit ("ITC" or "Credits") loss potential at a level that could exceed $200,000,000. Because, consistent with the tax normalization rules, the Company shares the benefits of its ITC with its customers, both Duke Energy Carolinas and its customers will suffer in the event of a violation. Moreover, the revenue requirement implications are substantially greater because the estimate is a tax credit figure (*i.e.*, "grossed-up" they exceed $300,000,000). Thus, the amounts the Order place at risk are patently all out of proportion to the costs at issue in this proceeding.

A. <u>The Tax Normalization Rules</u>

The Internal Revenue Code ("IRC") contains two sets of normalization rules. One set applies to the tax benefits of accelerated depreciation. The other applies to the ITC. At issue in this proceeding are the ITC normalization rules.

The ITC normalization rules were incorporated in the same 1971 legislation that enacted the "modern" ITC.[1] The ITC was structured as a credit against federal income tax equal to a percentage of the cost of certain new depreciable assets. Congress intended that, by lowering the cost of investing in such assets, this governmental "grant" would promote such investments. These incremental investments would increase the economic activity of the manufacturers of such assets as well as their suppliers and would increase the stock of new, productive equipment, all to the general benefit of the American economy. Critical to achievement of the desired result was that the Credit promote investment.

Based on state regulatory treatment of the Credits under the 1962 version of the ITC, Congress understood that, in the case of rate regulated utilities, the benefit of the Credit was susceptible of being contemporaneously extracted from the utilities for the immediate benefit of customers through the rate-setting process. Such extraction would, as far as the utility was concerned, eliminate any investment incentive. In fact, given utilities' duty to serve, there was skepticism at the time that regulated utilities needed or would respond as desired to the stimulus provided by the Credit. In the 1971 legislation, both issues were addressed. First, the ITC normalization rules were enacted to ensure that what was intended as a subsidy for the investment in assets would not be converted through the ratemaking process into a subsidy for the consumption of utility services. In general, these rules operate by keeping the grant money available to the utility to support

[1] Revenue Act of 1971 (P.L. 92-178, section 105). There was a prior version of the ITC enacted in 1962 (P.L. 87-834, section 2). This version originally had nothing like the normalization rules but was amended in 1964 (P.L. 88-272, section 203) to include a directive to federal agencies not to flow through the Credit. This Credit was suspended in 1967 (P.L. 90-225, section 2) and repealed in 1969 (P.L. 91-172, section 703).

its investments. Second, legislation provided a 7% ITC to most businesses but only a 4% credit to utilities who, presumably, needed it less.[2]

Locating the current ITC normalization rules is an exercise in legislative archeology. They were codified as part of the IRC from their enactment in 1971 through 1990,[3] notwithstanding that, in the Tax Reform Act of 1986,[4] Congress repealed the regular ITC. In the Revenue Reconciliation Act of 1990,[5] Congress attempted to "house-keep" the IRC by, among other things, stripping out the ITC normalization rules (which, due to the earlier repeal of the Credit, were considered "deadwood" provisions). However, in order to continue their application and operation (both as to previously claimed regular Credits as well as to the continuing rehabilitation Credit), IRC section 50(d)(2) was included in the 1990 legislation. That provision states:

> ***(d) Certain rules made applicable.***
> For purposes of this subpart, rules similar to the rules of the following provisions (as in effect on the day before the date of the enactment [11/5/90] of the Revenue Reconciliation Act of 1990) shall apply:
> **(1)** . . . .
> **(2)** Section 46(f) (relating to limitation in case of certain regulated companies).

The continued application of the ITC normalization rules applies "for purposes of this subpart...".[6] Thus, IRC section 50(d) applies the ITC normalization rules to specific credits included in the same subpart as the one in which it is located. That subpart includes IRC sections 46 through 50. Three of the sections, IRC sections 46, 49 and 50, do not grant credits but are operating provisions. The remaining four sections grant credits – all of which are subject to the ITC normalization rules through the mechanism

[2] This discrepancy was eliminated in the Tax Reduction Act of 1975 (P.L. 94-12, section 301) which increased the percentage to 10% for all taxpayers.
[3] Initially as IRC section 46(e) and later as IRC section 46(f).
[4] P.L. 99-514.
[5] P.L. 101-508.
[6] The IRC is divided into subtitles, chapters, subchapters, parts, subparts and, finally, sections.

of IRC section 50(d)(2). IRC section 47 establishes the rehabilitation credit.[7] IRC section 48 establishes the energy credit.[8] IRC section 48A establishes the qualifying advanced coal credit.[9] IRC section 48B establishes the qualifying gasification project credit.[10] Included in the IRC section 48 energy credit is the 30% solar energy production equipment credit – the credit to which the Company would be entitled as a result of its investment in the distributed generation solar assets proposed to be constructed under the CPCN granted in this proceeding.

To accomplish its goals for the Credit, Congress mandated that at least a designated portion of the benefit must be allocated to shareholders. The normalization rules effectively create a "floor" for the portion of the Credit that must benefit shareholders and a "ceiling" for the portion that can benefit customers.[11] During the two decades of their codification, the ITC normalization rules were statutorily modified on several occasions. However, the mechanics of the "sharing" provisions remained constant.

The 1971 legislation made two very specific regimes available to regulated utilities for compliance with the normalization rules: the ratable flow-through method and the ratable restoration method. Taxpayers could elect between them. The election with respect to the 4% ITC enacted in 1971 had to be made within 90 days of enactment

[7] The rehabilitation Credit pre-existed the Revenue Reconciliation Act of 1990. However, that legislation moved the various components of that Credit into Code section 47.
[8] The energy Credit also pre-existed the Revenue Reconciliation Act of 1990. That legislation moved the various components of that Credit into Code section 48. Until recently (*i.e.*, late 2008), this Credit was generally not available to regulated public utilities.
[9] This Credit was enacted as part of the Energy Tax Incentives Act of 2005, P.L. 109-58. Duke Energy Carolinas expects to claim $125 million of this Credit in connection with its construction of its Cliffside facility.
[10] This Credit was enacted as part of the Energy Tax Incentives Act of 2005, P.L. 109-58.
[11] *There had originally been an option to provide the entire benefit of the Credit to customers, but only if that is what* the utility had been doing with the benefits of accelerated depreciation prior to 1969. However, this option was eliminated by the Economic Recovery Tax Act of 1981, P.L. 97-34, after which all Credits became subject to the sharing requirements of the normalization rules.

of the legislation. Another election with respect to the incremental 6% Credit enacted in 1975[12] had to be made within 90 days of enactment also. In both cases, the election was, and remains, irrevocable.

Over 30 years ago, Duke Energy Carolinas elected to employ the ratable flow-through method with respect to its Credits. It remains irrevocably bound to that regime. That sharing system has two requirements. First, the Company can reduce its tax expense element of cost of service by no more than a ratable portion of the Credit. Second, the Company cannot offset rate base by any portion of the Credit. Under this regime, customers receive a reduction in their rates by an amount not in excess of a ratable amount of the Credit each year over the life of the asset that produced the Credit. This is the "ceiling" – the most they can receive. Shareholders receive a governmental grant which is available to fund their investment in rate base upon which they earn a return even though the investment is funded with government, not shareholder, funds (though the amount of the funds available for this purpose diminishes over the life of the asset as they are passed through to customers). Because there is no requirement that customers receive any benefit of the Credit whatsoever (*i.e.*, it is permissible to provide the entire benefit of the Credit to shareholders), this establishes a "floor" for the benefit shareholders must receive.

There are two concepts that are critical to the operation of the ITC normalization rules. The first is the notion of "ratable" – the limitation on the rapidity with which the Credit can benefit customers. The statute and the regulations promulgated thereunder are explicit on this point. "Ratable" is determined by reference to the regulatory life of the asset that generates the Credit. In short, customers get the benefit of the Credit over the

[12] P.L. 94-12

period that they fund the underlying asset. The second concept relates to the way in which the ITC normalization rules are administered. An assessment of whether these rules have been complied with is not limited to an inquiry into whether or not the two mechanical requirements regarding cost of service and rate base have been literally met. The applicable regulations[13] prescribe a much more intrusive evaluation. They state, in pertinent part:

> *(2) Cost of service.*
>
> (i) . . . .
>
> (ii) In determining whether, or to what extent, a credit has been used to reduce cost of service, ***reference shall be made to any accounting treatment that affects cost of service. ...***
>
> *(3) Rate base.*
>
> (i) . . . .
>
> (ii)
>
> (A) In determining whether, or to what extent, a credit has been used to reduce rate base, ***reference shall be made to any accounting treatment that affects rate base****....* (Emphasis added).

In each of the above excerpts, the highlighted language mandates an inquiry beyond mere superficial compliance with the rules. In fact, the regulations go further. In the very next subsection of those regulations, the following language appears:

> *(4) Indirect reductions to cost of service or rate base.*
>
> (i) Cost of service or rate base is also considered to have been reduced by reason of all or a portion of a credit if such reduction is made in an indirect manner.
>
> (ii) . . .
>
> (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—***

---

[13] Specifically, Treasury Reg. section 1.46-6(b).

> ***(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).

Thus, the regulations require an evaluation of the intent of the regulators. They even identify the sources of evidence to be considered in establishing this intent.

Congress decided that, should its intent in providing the tax subsidy be subverted by state regulatory action, the subsidy would be withdrawn. That is precisely the nature of the draconian penalty imposed upon a violation of the ITC normalization rules. When a violation occurs, under the rules of former IRC section 46(f), Credits are disallowed and no further Credits can be claimed. The disallowance applies to the greater of (1) all Credits claimed by the taxpayer in all years the tax returns for which are still open to adjustment under the statute of limitations or (2) all unamortized ITCs. [14] The amount of the disallowance is recaptured, *i.e.*, it must be paid back to the IRS. Finally, so long as the violation persists, no additional investment in otherwise qualifying assets will be eligible for Credit. The regulations clarify that the Credits subject to recapture and disallowance are those subject to the regulatory jurisdiction in which the violative order is imposed. Finally, within any regulatory jurisdiction, the penalty is not "scalable." If the ITC normalization rules are not complied with, then the penalties are imposed to the full extent, 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.

[14] Tax Reform Act of 1986, P.L. 99-514, section 211(b).

B. The Terms of the Order

North Carolina General Statute ("N.C. Gen. Stat.") § 62-133.8(h)(4) provides that an electric power supplier can recover the incremental costs incurred to comply with N.C. Gen. Stat. § 62-133.8(b)-(f) through an annual rider (the "REPS Rider"). Based on Finding of Fact ("FOF") 15, the third ordering paragraph on page 20 of the Order ultimately provides that the amount the Company can recover through the REPS Rider is limited to the excess of the third lowest solar bid submitted in response to its 2007 Request for Proposal for renewable energy over its avoided costs. Any Program costs in excess of this amount must be found to be recoverable through the REPS Rider as certain types of research costs (under N.C. Gen. Stat. § 62-133.8(h)(1)) or otherwise qualify as recoverable (presumably through base rates).

The Order suggests two bases for this FOF and for the Commission's ultimate conclusion. Both bases derive from the definition of "incremental costs" set forth in N.C. Gen. Stat. § 62-133.8(h)(1). That provision states, in pertinent part:

> For purposes of this subsection, the term "incremental costs" means all reasonable and prudent costs incurred by an electric power supplier to:
>
> a. Comply with the requirements of (b), (c), (d), (e), and (f) of this section that are in excess of the electric power supplier's avoided costs other than those costs recovered pursuant to G.S. 62-133.9.

The first basis is that costs in excess of the third lowest solar bid, whether or not unreasonable and imprudent, relate to the conduct of activities beyond those required to comply with the REPS statute. FOF 14 supports this view. The second basis is that all costs in excess of the cost of the third lowest solar bid are inherently unreasonable and imprudent. FOF 13 implies that this is the case. In either event, the Commission held that excess Program costs do not qualify as "incremental costs" within the meaning of N.C. Gen. Stat. § 62-133.8(h)(1).

The Commission's discussion in its Evidence and Conclusions for Findings of Fact 13-15 leaves no doubt as to its view with regard to the first basis. On page 14 of the Order the Commission states:

> 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 (the broader program purposes outlined by Duke *and compliance with tax normalization requirements*). Only the costs attributed to REPS compliance may be recovered through the REPS rider pursuant to G.S. 62-133.8(h)(1)(a). [Emphasis added.]

This language clearly creates two "buckets" of costs. The Commission specifically includes the costs of complying with the ITC normalization rules (*i.e.*, the incremental cost of not flowing through the full benefit of the Credit immediately to customers) in the bucket that is not incurred to comply with the REPS statute and which, hence, are not recoverable through the REPS rider. It is self-evident that the costs of normalization compliance cannot ever qualify as costs incurred to "[f]und research that encourages the development of renewable energy, energy efficiency, or improved air quality."[15] Consequently, although other costs in this unfavored bucket might yet be recovered through the REPS rider, ITC normalization costs will never be recoverable using that mechanism. The ultimate collection of these costs is, therefore, placed at risk with no clearly prescribed path to recovery.

With regard to the second basis, the Order takes great care to avoid concluding that any specific costs are unreasonable or imprudent. It states merely that Duke Energy

[15] Moreover, the $1 million limitation of N.C. Gen.Stat. § 62-133-8(h)(1)(b) is clearly insufficient to allow recovery of all of these costs.

Carolinas did not convince the Commission in the CPCN proceeding that costs in excess of the cost of the third lowest solar bid are reasonable and prudent. This finding is explicitly without prejudice to any future proceeding. Addressing specifically the costs of compliance with the ITC normalization rules, the Order states:

> 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. 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 <u>not</u> self-generating, but instead purchasing the needed solar energy.

Although this language stops short of finding normalization compliance imprudent, having dismissed the possibility that normalization compliance costs could justify the higher cost of the Company's Program, it is difficult to understand how, under the circumstances, such compliance could be found to be reasonable and prudent in a subsequent proceeding.

Thus, the Order identifies and discusses the costs of compliance with the ITC normalization rules, places them squarely within a bucket containing other unfavored costs and fails to establish a process that provides any confidence that they will be recovered. In fact, if anything, it discourages the prospect. In short, the Order explicitly sets up normalization compliance costs for complete or partial disallowance.

C. <u>The Consequences of the Order Under the Normalization Rules</u>

Treasury Reg. section 1.46-6(b) excerpted above prohibits indirect reductions to cost of service or rate base. Determining whether an indirect reduction has occurred must be based on a consideration of the relevant facts and circumstances. Among the facts to be considered are: the record of the proceeding, the Order itself, as well as the revenue impact of the Order. The Order indicates that this Commission intended to identify and to segregate the costs of normalization compliance in a way that indicates, at the very least, hostility to them.

The effect of any subsequent disallowance, although not a *per se* more-than-ratable Credit flow-through, is a textbook example of an indirect one. Normalization compliance is referred to in the Order approximately 10 times between pages 4 and 16. Because the context of these discussions makes it clear that the cost of normalization compliance represents the incremental cost of not flowing through the full benefit of the Credit immediately to customers, the complete disallowance of the cost would be the mathematical equivalent of flowing through the entire benefit of the Credit immediately – the polar opposite of the ratable flow-through required for compliance with the ITC normalization rules. Moreover, because full compliance with the normalization rules requires the recovery of all of the incremental costs, a partial disallowance of those costs creates less than full compliance with the rules. Consequently, a partial disallowance would similarly constitute a breach of the ratable requirement. And, as indicated previously, any partial failure to comply with the ITC normalization rules constitutes a total failure to comply and the full measure of the penalties becomes applicable. Thus, the consequences of such a disallowance should not be in doubt.

D. The Effect of the Order on Duke Energy Carolinas

The Order places Duke Energy Carolinas in an untenable position. On the one hand, this Commission has granted the Company a CPCN to build out distributed solar generation – something the Company strongly believes to be in the best interests of its customers and the State of North Carolina. On the other hand, proceeding based on the

Order will expose Duke Energy Carolinas and its customers to the forfeiture of hundreds of millions of dollars of past and future Credits. The Company cannot in good conscience accept a risk of this magnitude. Consequently, Duke Energy Carolinas respectfully requests that the Commission alleviate this risk by withdrawing the Order in its entirety and issuing a new order. To the extent that the Commission has determined that the costs of the Company's Program are divisible, this new order should specifically include the costs of compliance with the tax normalization rules as "incremental costs" within the meaning of N.C. Gen. Stat. § 62.133.8(h)(1) and permit them to be recovered through the REPS rider. Such an action would be completely consistent with the fundamental nature of these costs – costs imposed by federal law indispensable to the successful implementation of the CPCN. Alternatively, the order should provide the Company with assurance that (a) proceeding with implementation of the Program is reasonable and prudent, and (b) the Company may recover all costs incurred in executing the Program through a combination of the REPS rider and base rates, subject only to the Commission's review of the reasonableness or prudence associated with Duke Energy Carolinas' execution of the Program. The authority for this alternative is addressed more fully below.

II. The Existing Record as Supplemented by the Affidavit of Ms. Melisa B. Johns, Supports a Conclusion that Implementing the Program and Providing the Relief Requested by Duke Energy Carolinas is Reasonable and Appropriate.

The Company's Motion for Reconsideration articulates in detail the factual and policy bases for its positions that (a) the comparison of the Program to the solar bids in the renewable RFP is inappropriate and ignores the benefits of distributed generation and utility ownership of solar generation; (b) the use of the third place bid as a proxy for the

REPS compliance value of the Program is arbitrary and without sufficient basis; and (c) the Commission's precedent and the record in this proceeding support the alternative request for assurance that proceeding with the Program is reasonable and prudent. These sections of the Motion at pages 8 through 17 are incorporated herein by reference. These positions collectively support a finding by this Commission that the costs of the Program in excess of the third lowest solar bid represent "incremental costs" within the meaning of N.C. Gen. Stat. §62-133.8(h)(1). In addition, Duke Energy Carolinas provides the following legal and policy support for these positions.

A. <u>The Arbitrary and Capricious Standard</u>

Commission decisions are "arbitrary and capricious when, among other things, they indicate a lack of fair and careful consideration or fail to display a reasoned judgment." *State of North Carolina v. Thornburg*, 314 N.C. 509, 515 (1985) (citing *Comr. of Insurance v. Rate Bureau*, 300 N.C. 381, 420 (1980)). Additionally, an order in which the Commission accords only "minimal consideration to competent evidence" constitutes error at law and is correctable on appeal. *Utilities Commission v. Gas Co.*, 254 N.C. 536, 550-552 (1961); *see also* N.C. Gen. Stat. § 62-94. Moreover, decisions of the Commission which are arbitrary or capricious and which prejudice the substantial rights of the appellants are not binding on a reviewing court. N.C. Gen. Stat. § 62-94.

The Company respectfully submits that the Order does not afford careful consideration to the merits of Duke Energy Carolinas' proposal regarding the recovery of the costs for the Program, nor displays sufficiently reasoned judgment regarding the Public Staff's argument that a cap on the Company's recovery of Program costs through the REPS rider based upon the third lowest solar bid is appropriate. The Commission acknowledged the Public Staff's admission that the basis of its proposed cost cap is "subjective." Order at 16. The Commission adopted this subjective proposal, despite the uncontested evidence of the series of unreasonable assumptions upon which it is based. Additionally, the affidavit of Melisa B. Johns further demonstrates that although the bid prices are informative in comparing relative cost estimates, they are simply not definitive enough for establishing an inflexible maximum recovery amount.

Company witness Jane L. McManeus testified to this effect at the evidentiary hearing, stating that "it is not rare to receive a bid and then end up negotiating the details of the contract and end up with a different" and potentially higher price. T. Vol. 2, at 85-86. Company Witness Owen Smith, responding to cross-examination by counsel for the Public Staff who was attempting to quantify a so-called "true solar cost," testified:

> Your question requires one to assume that the second-place bidder in the RFP was a price and a developer . . . that had no risk of changing, that the price as originally proposed would not change if we had undertaken extensive negotiation with that bidder to finalize terms and conditions, and would also require us to have full confidence that the project as proposed would come to fruition as proposed. Those are assumptions that, I think, stretch beyond what I would be comfortable making.

T. Vol. 1 at 147-48.

Ms. Johns elaborated on this in her affidavit, explaining that a solar bid price cannot be considered a firm price and is not a reliable indicator of the actual price Duke Energy Carolinas will have to pay when solar energy is actually delivered years after the bid is submitted. This is because the seller's bid price to Duke Energy Carolinas is based on its assumptions regarding all of its project costs. Additionally, there are myriad critical matters that a bid price is contingent upon, including, but not limited to, finding an acceptable site, confirming the site's suitability through due diligence, obtaining an interconnection to the buyer, and obtaining financing at projected rates. In the face of this evidence that the basis for the cost cap is both subjective and questionable, the limitation on recovery of the Program costs is questionable. (*See State of North Carolina v. Atlantic Coast Line Railroad Co.*, 268 N.C. 242 (1966), holding that the Commission's finding that one full-time agent could not meet the needs of two train stations ignored the undisputed evidence that at both stations, the agent spent approximately half the day with nothing to do.).

In addition, the Commission gave only minimal consideration to the evidence regarding the difference between the Program and the large scale, ground-mounted solar facilities bid in the RFP and the additional benefits that the Program is expected to provide. The Company incorporates by reference its articulation of those benefits set forth in its Application, direct and rebuttal testimony, post-hearing brief, and motion for reconsideration in this docket, but nonetheless summarizes them as (1) promoting energy security; (2) leveraging volume purchases and building relationships with PV manufacturers and installers; (3) enabling customers to directly participate in the development of renewable resources in North Carolina without the requirement of making a significant capital investment, an investment likely would not occur in today's financial climate; and (4) enabling the Company to gain operational knowledge concerning the effects of solar PV distributed generation that cannot be gained through purchased power or renewable energy certificate purchases.

The Commission stated in its Order that the Company described these benefits only in "vague and conceptual terms." The Company can only surmise that the Commission found the benefits to be vague because the Company did not provide a quantitative analysis of such benefits. To attempt to provide such data, however, would be an inherently subjective endeavor. An existing program would provide the most reliable metrics for such an analysis, and there are none that currently exist in the United States. Although the Company would not have proposed the Program but for the REPS requirements, in complying with its REPS requirements Duke Energy Carolinas seeks to be a leader in the development of utility-owned rooftop solar distributed generation in order to both advance the solar market and develop expertise ahead of the emerging trend towards distributed generation. Given that this concept is new, the Company articulated the Program benefits in qualitative terms. As discussed in the Motion for Reconsideration, the testimony describes in detail the Program benefits and benefits of utility-owned solar distributed generation, and explains why the Company cannot rely on third parties to achieve these benefits. Motion for Reconsideration at 8-13. The Commission afforded the Public Staff's admittedly subjective (and thus essentially qualitative) evidence regarding the compliance value of the Program undue weight at the same time it dismissed Duke Energy Carolinas' justifiably qualitative evidence of the additional Program benefits.

The Company submits that upon fair and careful reconsideration it is appropriate for the Commission to issue a new order to eliminate the condition that Program cost recovery through the REPS rider be capped at the third lowest solar bid.

B. <u>Request for Declaration of Assurance</u>

In its March 20, 2007, order in Docket No. E-7, Sub 819, the Commission declared that (1) proceeding with development work necessary to ensure that nuclear generation remains a available resource option is appropriate and consistent with the promotion of adequate, reliable, and economical utility service and the policies expressed in N.C. Gen. Stat. § 62-2; and (2) to the extent the Commission finds in a future general rate case that the specific activities involved in and the costs of pursuing such development work to be prudent and reasonable that such costs will be recoverable in rates. *Order Issuing Declaratory Ruling*, Docket No. E-7, Sub 819 (March 20, 2007) ("Declaratory Order") at 22-23.

The Commission determined that it had the authority to issue such a declaration and concluded that it was appropriate to provide Duke Energy Carolinas with assurance that at the appropriate time for the development costs associated with the Lee Nuclear station to be considered for inclusion in rates, that such costs would not be rejected out of hand because the activity of incurring them was not prudent. *Id.* at 22-23. Moreover, the Commission stated that its order

> would clearly provide the requested assurance, and Duke would have the opportunity to recover its reasonable and prudently-incurred costs for Development Work in a future general rate case proceeding. These 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 general assurances.

Id. at 23.

In this case, the Company is faced with the situation under which it is seeking to fulfill its obligations to meet customer demands with solar energy resources as required by the REPS requirement and pursuing the stated policy of North Carolina to promote the development of renewable energy under N.C. Gen. Stat. § 62-2(10); yet it is faced with the unacceptable risk of not simply cost disallowance, but of significant federal tax penalties due to the unique factors present here. Commission assurance that proceeding with the Program is reasonable and prudent will alleviate the risk of violation of the federal tax normalization rules by demonstrating that the Commission does not intend to prohibit the Company from recovering the Program costs in excess of the third place solar bid due to the fact that certain of these costs exist as a result of the normalization requirements. Rather, any disallowance of costs would be the result of specific findings as to the manner in which the Company executed the Program.

In Docket No. E-7, Sub 819, the Company demonstrated the importance of taking action to ensure that nuclear generation remains a resource option for Duke Energy Carolinas' customers and the Commission concluded that "it is in the public interest for all potential resource options, including nuclear generation, to be adequately considered to ensure that the most economical resources are available to meet customers' needs on a timely basis." Declaratory Order at 22. Similarly, as discussed earlier, the evidence in the record as well as the affidavit submitted with the Company's Motion for Reconsideration support similar action by the Commission in this case. This evidence demonstrates the importance of pursuing utility-owned solar generation generally and utility-owned solar distributed generation in particular. The Commission granted assurance in the Lee Nuclear development cost proceeding in recognition of the risks inherent in the development of nuclear generation. Likewise, in this case, the Company needs similar assurance in light of the significant federal tax risk.

CONCLUSION

Duke Energy Carolinas respectfully requests that the Commission withdraw the Order in its entirety and issue a new order consistent with the Company's requested relief. The Company requests that the Commission issue a new order that eliminates the condition limiting recovery of Program costs through the REPS rider to the third lowest solar bid such that all of its Program costs, including the costs of compliance with the tax normalization rules, will be recovered through that mechanism. In the alternative, the Company respectfully requests that the Commission provide the Company with assurance that (a) proceeding with implementation of the Program is reasonable and prudent, and (b) the company may recover all costs incurred in executing the Program through a combination of the REPS rider and base rates, subject only to the Commission's review of the reasonableness or prudence associated with Duke Energy Carolinas' execution of the Program. Without such relief, the Company will be forced to abandon the Program completely, eliminating the opportunity for the installation of significant solar distributed facilities on its system.

Respectfully submitted this 4th day of March, 2009.

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CERTIFICATE OF SERVICE

I certify that a copy of Duke Energy Carolinas, LLC's Initial Brief in Support of its Motion for Reconsideration 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 4th day of March, 2009.

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