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NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION

FILED
APR 29 2011
Clerk's Office
N.C. Utilities Commission

April 29, 2011

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

Re: Docket No. E-100, Sub 127
Biennial Determination of Avoided Cost Rates

Dear Ms. Vance:

Please find attached 21 copies of the Public Staff's Proposed Order for filing in the above-referenced docket. As indicated in the attached proposed order, the Public Staff has begun its investigation of New River's proposed avoided cost rates, which were filed on March 21, 2011, and revised on April 20, 2011. However, the rates as filed present a number of difficult issues, particularly given the FERC's recent orders in the *J.D. Wind* cases, 129 FERC ¶ 61,148 (2009), *reconsideration denied*, 130 FERC ¶ 61,127 (2010), and the Commission's recent interpretations of PURPA with those cases in mind. These also raise issues about the appropriateness of WCU's proposed formula rates and lack of long-term rate options. The Public Staff proposes to make a separate filing with respect to the appropriate avoided cost rates and standard contracts for both WCU and New River and proposes that the Commission determine the appropriate avoided cost rates for WCU and New River by separate order.

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By copy of this letter, all parties of record are being served.

Sincerely,

Gisele L. Rankin

Gisele L. Rankin
Staff Attorney

Attachment

cc: Parties of Record

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	)))	THE PUBLIC STAFF'S PROPOSED ORDER

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 Warren Rabon, ToNola D. Brown-Bland, and Lucy T. Allen

APPEARANCES:

For Duke Energy Carolinas, LLC:

Robert W. Kaylor, Law Office of Robert W. Kaylor, P.A., 3700 Glenwood Avenue, Suite 330, Raleigh, North Carolina 27612

Kendrick Fentress, Associate General Counsel, Duke Energy Corporation, 3700 Glenwood Avenue, Suite 300, Raleigh, North Carolina 27612

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

Len S. Anthony, General Counsel, Post Office Box 1551, PEB 17A4, Raleigh, North Carolina 27602

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

Robert W. Kaylor, Law Office of Robert W. Kaylor, P.A., 3700 Glenwood Avenue, Suite 330, Raleigh, North Carolina 27612

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 the four 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 qualifying facilities 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, 2010. 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 nonexpert 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.

The following parties filed timely petitions to intervene that were granted: The Public Works Commission of Fayetteville, the North Carolina Sustainable Energy Association, the Carolina Industrial Group for Fair Utility Rates I, II, and III, Carolina Utility Customers Association, Inc., 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 on March 16, 2011. Pursuant to a further extension of time, PEC, DEC, 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 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 five MW or less capacity. The standard levelized rate options of ten or more 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 three 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 five 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 five MW or less capacity. The standard levelized rate options of ten or more 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 three 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 five 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 five MW or less capacity. The standard levelized rate options of ten or 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 three 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 process derived from the markets operated by PJM Interconnection, LLC (PJM), subject to the same conditions as approved in the 2006 biennial avoided cost proceeding.

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: (a) participating in the utility's competitive bidding process, (2) negotiating a contract and rates with the utility, or (c) selling energy at the utility's Commission-established variable energy rate, or (c) selling energy at the Commission-established variable energy rate. 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 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 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 cost.

10. Currently approved avoided cost rates may become unavailable upon the filing of proposed new rates in the next biennial avoided cost proceeding, but only if those proposed new rates become available, subject to true-up, at the point in time when the currently approved avoided cost rates become unavailable. The true-up shall allow QFs to have their payments increased if the Commission approves avoided cost rates higher than the rates proposed by the utilities, without such rates being subject to being decreased if lower rates are approved.

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

12. The requirement in NC Power's Schedule 19-DRR that requires a QF to repay any amounts disallowed for ratemaking purposes is inappropriate and should be removed from the rate schedule.

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. 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.

14. The appropriate avoided cost rates for WCU and New River should be determined by separate order.

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 five MW or less capacity or the availability of five-year levelized rate options to all other qualifying facilities contracting to sell three 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 five MW or less and to QFs contracting to sell five MW or less that are fueled by trash or methane from landfills, hog waste, poultry waste, solar, wind, and non-animal forms of biomass contracting to sell five MW or less capacity and that they should offer their five-year levelized rate options to all other qualifying facilities contracting to sell three 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 or not NC Power's standard rate options are sufficiently fixed to comply with the FERC's recent interpretation of PURPA in the *J.D. Wind* cases.[1] On rehearing of its *J.D. Wind* cases, 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." (February 19 Order, ¶ 23) The FERC went on to say that it has consistently affirmed the QF's right 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.

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, 2011, Schedule 19-DRR, Section VI(B).) Given the FERC's recent *J.D. Wind* orders and this Commission's interpretation of those orders, the Public Staff that it is not clear that this consistent with PURPA.

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[1] *J.D. Wind 1, LLC*, 129 FERC ¶ 61,148 (2009), *reconsideration denied*, 130 FERC ¶ 61,127 (2010)(February 19 Order).

NC Power in its reply comments stated that under its proposed Schedule 19-DRR, energy rates for QFs above 100 kW are fixed in two-year increments over the life of the standard agreement through one of two methods. A QF may elect to (1) receive the variable energy payment, which is re-determined every two years in the biennial proceeding, or (2) receive energy payments based on long-term levelized generation mixes with adjustable fuel prices. NC Power further stated that this biennial reset method is not a recent development, having been first approved by the Commission on an experimental basis in 1989 in Docket No. E-100, Sub 57. NC Power asserted that the Commission approved it on a permanent basis in Docket No. E-100, Sub 59. NC Power further opined that in another context in 1998 the FERC had provided insight into what might be permissible, stating that a fixed formula rate would satisfy the requirement that the rates for purchase by a utility are established in advance of the purchase. NC Power argued that its biennial reset method is such a fixed formula rate.

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. Language from this section of the FERC's proposed regulation (which was never approved) not quoted by NC Power clearly establishes that such a formula rate would have to be predictable and quantifiable so that financing could be obtained. 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, has made it very clear that it cannot obtain financing if the currently approved reset for changes in fuel prices was all that was on offer. 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 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, NC Power is 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.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The Commission concluded in past biennial proceedings that QFs not eligible for the standard long-term levelized rates should have three options the following three options if the utility has a Commission-recognized active solicitation: (a) participating in the utility's competitive bidding process, (2) negotiating a contract and rates with the utility, or (c) selling energy at the utility's Commission-established variable energy rate, or (c) selling energy at the Commission-established variable energy rate. 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 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 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.

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 reaffirmed 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. (See Docket No. E-100, Subs 53, 74, and 106.) 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 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 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 cost.

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 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 (CPCN) 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 the arbitration proceedings in Docket Nos. E-2, Sub 966, and SP-467, 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 their reply comments, all three utilities argued against continuing to make currently approved avoided cost rates available after the filing of new, proposed avoided cost rates. Duke argued that its making the currently available variable rates available to QFs seeking a contract while the Commission's review of its proposed avoided costs rates is underway was all that was necessary to comply with PURPA.

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. This issue was raised specifically in Docket No. E-7, Sub 978, by an existing QF seeking to sign a new long-term standard contract following the expiration of its existing contract and being offered only a variable rate for the interim period. 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.

Based upon the foregoing, the Commission concludes that, given the requirements of PURPA, the appropriate course of action is to permit the utilities to include tariff language that allows the currently approved avoided cost rates to become unavailable upon the filing of proposed new rates in the next biennial avoided cost proceeding, but only if those proposed new rates become available, subject to true-up as defined herein, at the point in time when the currently approved avoided cost rates become unavailable. The true-up shall allow QFs to have their payments increased if the Commission approves avoided cost rates higher than the rates proposed by the utilities, without such rates being subject to being decreased if lower rates are approved. This satisfies the concerns raised by both the Public Staff and the utilities with respect to balancing the interests of the QF and the utility ratepayers, while being consistent with this Commission's interpretations of PURPA.

DISCUSSION AND CONCLUSIONS FOR FINDING OF FACT NO. 11

In response to the Public Staff's recommendations with respect to the unavailability of avoided cost rates after the expected due date for the utilities' filing of proposed new rates, PEC, in its reply comments, proposed that a viability prerequisite for QFs be incorporated into the current framework. 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 took the position 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 a legally enforceable obligation (LEO) has occurred. In any event, 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 inappropriate to revisit the Commission's prior decisions as to when an LEO has occurred in this proceeding. 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 high 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

NC Power's current standard agreement provides in effect that if relevant state regulatory authorities or the FERC disallow payments under the agreement for ratemaking purposes, the QF is required to repay such amounts (as defined in the agreement) within 28 days. The Public Staff, in its Initial Statement, stated that, given that a standard agreement for renewable QFs contracting to sell five 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 when language was proposed that would have allowed existing standard contracts to be amended as the result of subsequent governmental or judicial action. (See, Order dated April 1, 1983, relating to Duke Power Company, which was affirmed by the full Commission by Order dated June 3, 1983 (except in one instance not relevant here) in Docket No. E-100, Sub 41.

In its reply comments, NC Power argued that NC Power and its shareholders should not bear even the remote possibility that its shareholders would bear the burden of a ratemaking disallowance, and there was no evidence that the provision was likely to discourage QF development.

The Commission concludes that the risks from disallowance posed by the standard contracts are too low to justify the regulatory disallowance provision included by NC Power in its Schedule 19-DRR, particularly given the Commission's prior, long-standing rejection of provisions that would allow pre-existing standard contracts to be changed as a result of judicial or governmental actions and the potential chilling effect this might have on the development of small QFs. This requirement in NC Power's Schedule 19-DRR is inappropriate and should be removed from the rate schedule.

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 shall 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 the FERC's recent orders in the *J.D. Wind* cases and the Commission's recent interpretations of PURPA with those 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.

Based upon the foregoing, the Commission concludes that the appropriate avoided cost rates for WCU and New River shall be determined by separate order.

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 five 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 five MW or less capacity. The standard levelized rate options of ten or more 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 three 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 five 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 five MW or less capacity. The standard levelized rate options of ten or more 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 three MW or less capacity.

3. That NC Power shall be required to 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 five 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 five MW or less capacity. The standard levelized rate options of ten or 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 three 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 process 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 options, 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 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: (a) participating in the utility's competitive bidding process, (2) negotiating a contract and rates with the utility, or (c) selling energy at the utility's Commission-established variable energy rate, or (c) selling energy at the Commission-established variable energy rate. 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 the standard long-term levelized rates shall have the option of selling into the wholesale market. The exact points at which an active solicitation is 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 cost.

10. That the tariffs of the utilities may provide that currently approved avoided cost rates become unavailable upon the filing of proposed new rates in the next biennial avoided cost proceeding, but only if those proposed new rates become available, subject to true-up, at the point in time when the currently approved avoided cost rates become unavailable. This true-up shall allow QFs to have their payments increased if the Commission approves avoided cost rates higher than the rates proposed by the utilities, without such rates being subject to being decreased if lower rates are approved.

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

12. That the requirement in NC Power's Schedule 19-DRR that a QF repay any amounts disallowed for ratemaking purposes shall be removed from the rate schedule.

13. 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 are 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. 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.

14. That the appropriate avoided cost rates for WCU and New River will be determined by separate order.

ISSUED BY ORDER OF THE COMMISSION.

This the ____ day of ____________ 2011.

NORTH CAROLINA UTILITIES COMMISSION

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Renné Vance, Chief Clerk