STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 856

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Application of Duke Energy Carolinas, LLC, for Approval of a Solar Photovoltaic Distributed Generation Program and for Approval of the Proposed Method of Recovery of Associated Costs	)))))	ORDER ON RECONSIDERATION

BY THE COMMISSION: On June 6, 2008, Duke Energy Carolinas, LLC (Duke), filed an application for a blanket Certificate of Public Convenience and Necessity (CPCN) authorizing construction over a two-year period of up to 20 megawatts (MW) direct current (DC) of solar photovoltaic (PV) generation and for approval of its proposed method of cost recovery. Duke stated that its proposed program would meet its need to acquire solar energy in order to satisfy the solar set-aside requirements of the North Carolina Renewable Energy and Energy Efficiency Portfolio Standard (REPS), G.S. 62-133.8(d). The proposed facilities will be dispersed throughout Duke's North Carolina service territory and will be installed as roof-mounted and ground-mounted facilities on the property of Duke's customers and on property owned by Duke. In its application, Duke estimated that the cost of the proposed facilities would be approximately $100 million. In its rebuttal testimony, Duke reduced the size of its proposed program to 10 MW (DC), with an estimated cost of $50 million.

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

Duke further stated in its application that, in addition to simply providing solar energy to meet the REPS requirements, the program will provide certain additional benefits which it believes cannot be obtained through a purchase from a third party. These additional benefits include enabling Duke to develop competency as an owner of solar renewable assets; to leverage volume purchases; to build relationships with solar PV developers, manufacturers and installers; to gain experience with the installation and operation of various types of solar distributed generation facilities; and to evaluate the impact of such facilities on its electric system. In addition, Duke expects

that the program will help it to understand the types of distributed generation facilities desired by customers, promote the commercialization of solar facilities in North Carolina, and fill knowledge gaps so as to enable successful, widespread deployment of solar PV technologies. Moreover, Duke noted that, if it owns solar generating facilities, it will not be entirely dependent on purchases from outside entities to meet the solar requirements contained in the REPS.

On December 31, 2008, the Commission issued an Order granting Duke's application for a CPCN to implement its proposed 10 MW solar PV distributed generation program and to construct the associated generating facilities. The Order, however, provided that no more than the effective price per megawatt-hour (MWh) submitted by the third-place solar bidder in response to Duke's 2007 request for proposals (RFP), as stated in Public Staff Smith Confidential Cross-Examination Exhibit 1, less Duke's avoided costs, may be recovered through the REPS and REPS EMF riders pursuant to G.S. 62-133.8(h)(1)(a). This restriction was without prejudice to Duke's right to apply for recovery of any remaining costs of the program pursuant to G.S. 62-133.8(h)(1)(b). The Commission further stated that the issuance of that Order did not constitute approval of Duke's final costs for ratemaking purposes and was without prejudice to the right of any party to take issue with the ratemaking treatment of the final costs in a future proceeding.

In its Order, the Commission cited evidence in the case that one reason Duke's costs were projected to be higher than the costs in the third-place RFP bid was that Duke was required to comply with normalization requirements with respect to investment tax credits while the nonregulated third-place RFP bidder faced no comparable constraints. The Commission's Order contained language suggesting that if Duke's costs were higher than the third-place bidder, this fact might indicate that the prudent course for Duke to take would be to forego the self-build option in favor of reliance on the less expensive third party generator.

On January 29, 2009, Duke filed a Motion for Reconsideration of the Commission's December 31, 2008 Order. In its Motion, Duke contended that limiting the amount of program costs recoverable through the REPS riders places the Company in jeopardy of violating the federal tax normalization requirements. Duke also contended that the Commission inappropriately has sent the Company mixed signals by approving the CPCN while, at the same time, suggesting that the Company faces potential future prudency disallowances for choosing the self-build over the third-party option.

On February 2, 2009, the Commission issued an Order Allowing Briefs on Motion for Reconsideration and Scheduling Oral Argument.

On March 4, 2009, initial briefs were filed by the following parties: Duke, Southern Alliance for Clean Energy, North Carolina Sustainable Energy Association (NCSEA), The Solar Alliance, the Attorney General, and the Public Staff. On March 18, 2009, Duke, NCSEA, and the Public Staff filed reply briefs. Carolina Utility Customers Association, Inc. (CUCA), filed a letter in lieu of a reply brief.

Oral argument was heard on March 23, 2009, as scheduled. Appearances were entered by counsel for Duke, The Solar Alliance, the Attorney General, and the Public Staff. In its brief and oral argument, the Public Staff suggested modifications that, in its view, eliminate concerns over violations of the federal tax normalization requirements; the Attorney General and Solar Alliance opposed Duke's Motion for Reconsideration.

DISCUSSION AND CONCLUSIONS

After careful review of the arguments of the parties, the Commission concludes that its December 31, 2008 Order should be modified to negate language determining or suggesting that Duke risks an imprudence disallowance in a future case resulting from its decision to proceed with its self-build program rather than contracting with a third-party solar generator. However, the requirements in the December 31, 2008 Order limiting costs to be recovered through the REPS riders shall remain in place. To the extent that decisions Duke makes in implementing the program, other than its decision to proceed, are questioned on grounds of prudence or reasonableness, nothing in this Order prevents any party from raising such issues in a future case.

The Commission agrees with Duke that the prudency of Duke's decision to proceed with its program, the self-build option, is an issue the Commission appropriately should address in this CPCN proceeding undertaken pursuant to G.S. 62-110.1. The investigation the Commission must make in compliance with this statute requires it to balance factors such as those at issue in this case in making its threshold determination of whether the issuance of the CPCN furthers the public convenience and necessity. State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co., Inc., 346 N.C. 558, 488 S.E.2d 591 (1997). It is inappropriate to authorize Duke to proceed with its program, but to leave this threshold issue, raised by contested facts in the docket, unresolved while even suggesting that Duke's decision to proceed with the self-build option may be an imprudent choice for which it may face a disallowance penalty in the future.

The Commission faced a similar issue in dockets addressing Duke's requests for CPCNs for combined cycle gas-fired generating stations at Dan River and Buck, Docket No. E-7, Subs 791 and 832. There, a third-party generator questioned Duke's decision to choose the self-build option over the proposals of third-party generators which had submitted bids in response to an RFP. The Commission resolved that issue in its order granting Duke the requested CPCN. The Commission similarly should resolve the issue here.

Proper resolution of the issue based on the facts before the Commission presents substantial difficulty. The third-place bid that played a prominent role in the Commission's December 31, 2008 decision contains a substantially lower price per MWh than Duke's self-build option. The Commission bears the responsibility of protecting ratepayers by prohibiting utilities like Duke from incurring unreasonable and excessive costs, whether those costs are excessive in comparison to acceptable alternatives because of more expensive materials, labor, financing costs or unfortunate requirements of tax normalization regulations. Were the decision to be based on price alone, Duke's request for a CPCN should be denied.

Countervailing factors of record in this case that are set forth in the December 31, 2008 Order include the fact that bids submitted in response to RFPs are not firm and final, but often are subject to substantial modification and adjustment as the proposed project proceeds. Of particular significance to the Commission's decision are the facts Duke has presented with respect to another bid, which Duke accepted, set forth in the post-order affidavit of Melisa B. Johns accompanying Duke's Motion for Reconsideration.

At the hearing, Duke witness McManeus testified 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 potential higher, price. In addition, Ms. Johns' affidavit demonstrates that a solar bid price cannot be considered a firm price and is not a reliable indicator of the actual price Duke will have to pay when solar energy is actually delivered years after the bid is submitted. Ms. Johns explained that many factors related to a supplier's product and pricing can change as a renewable project proceeds from an initial bid to a finalized, executed contract, and finally to actual construction of a generating facility and the delivery of energy.

Virtually all renewable energy bidders are project-financed. Therefore, the seller must have a long-term power sales agreement executed before the seller is able to proceed to obtain financing and construct the facility. The seller's bid price to Duke is based on its assumptions regarding all its project costs. Accordingly, the seller's bid price generally is contingent upon critical matters, such as: the seller finding an acceptable site; performing due diligence on that site to confirm the suitability of that site; obtaining an interconnection to the buyer's system at an acceptable cost; obtaining the projected tax credits for the project; avoiding unexpected state or local taxes on the project; obtaining financing at projected rates; and meeting the energy buyer's credit or performance requirements within project costs. In addition, some bids contain cost pass-through provisions under which specific types of cost (such as tax increases) are passed through to the buyer directly instead of being included in the energy price.

According to Ms. Johns' affidavit, the solar bids received in response to the 2007 RFP, including the third-place solar bid, incorporate these types of contingencies. Even after the energy contract is signed, the price is still not truly firm because the seller and the seller's lender will often require that the contract contain condition precedents, which may allow the seller to terminate the project if certain of the contingencies are not satisfied. Thus, although bid prices are informative in comparing relative cost estimates, they are not definitive enough for establishing an inflexible maximum recovery amount.

Duke faces compliance with the REPS solar set-aside requirement under Senate Bill 3 as early as 2010. After balancing all of the factors in favor of granting Duke the CPCN against those weighing in favor of denial, the Commission determines that Duke's request should be granted and that Duke's decision to proceed with the distributed generation program is not imprudent.

The Commission determines that the limitations set forth in the December 31, 2008 Order constraining the costs recoverable through the REPS riders should remain in

place. While the Commission grants Duke's CPCN to implement the self-build distributed generation program even though the cost is in excess of bids received in response to Duke's RFP, the Commission remains unwilling to permit Duke to recover all of these costs through the REPS riders. The Commission remains concerned that undue reliance on relatively expensive solar generation from Duke's program will result in Duke's reaching the price caps under Senate Bill 3 before meeting the solar set-aside requirement, or will so nearly approach the cap that acquisition of solar generation from other sources is substantially limited. Likewise, the Commission interprets Senate Bill 3 as endorsing efforts to spur a market in renewable generation in which a diversity of generators participates so that prices will decline. These considerations support leaving the limitations in place. While use of the third-place bid price is only one of a number of ways to establish the limitation and has been criticized by Duke as being arbitrary, the Commission reaffirms its determination that reliance on this metric is reasonable. Furthermore, Duke, in its Motion for Reconsideration, briefs and oral argument, agreed that this limitation is acceptable.

Substantial difficulty and sharp dispute giving rise to the Motion for Reconsideration arise from provisions in the December 31, 2008 Order purporting to assign incremental costs above avoided costs into categories recoverable through the various cost recovery mechanisms on the basis of the purpose for which the costs were incurred. The Commission determines that efforts to assign incremental costs to categories, as though they were divisible, based on the reason the costs were incurred were ill-advised and were not supported by record evidence. To the extent such assignments were made in the December 31, 2008 Order, they are hereby withdrawn. Instead, the Commission determines that the incremental costs are indivisible and cannot be assigned to categories, such as costs incurred to meet the REPS solar set-aside, to realize the broader objectives of the program, or as a result of tax normalization requirements. The only categorization of the incremental costs is the division of those recoverable through the REPS and REPS EMF riders and those recoverable through base rates, and this categorization is made, as explained above, for reasons other than the purpose for which they were incurred. The categorization is made to retain headroom for compliance with the REPS requirements. As such, the Commission determines that no portion of the costs of Duke's program may be recovered through the REPS riders as research and development costs under G.S. 62-133.8(h)(1)(b).

Resolution of the issues as discussed above renders moot Duke's arguments that the December 31, 2008 Order jeopardizes the continued availability of investment tax credits through indirectly providing ratepayers benefits in excess of those allowed by regulations. Nonetheless, the Commission stresses that its determination to grant Duke relief in response to its Motion for Reconsideration is based on arguments other than the tax arguments upon which much of its Motion are based. Nothing in the December 31, 2008 Order is part of a Commission effort "to negate the impact of the normalization compliance costs" or to disallow plant costs with a "intent [to] merely finesse the normalization rules." The Commission's language expressing skepticism over Duke's choice of the more expensive self-build alternative addressed the determination to choose a more costly alternative over another one. Any hypothetical

reference to imprudence was to Duke's paying a price per MWh for solar-generated power in excess of lower-priced bid proposals submitted in response to Duke's RFP, not to Duke's use of investment tax credits.

IT IS, THEREFORE, SO ORDERED.

ISSUED BY ORDER OF THE COMMISSION.

This the 6th day of May, 2009.

NORTH CAROLINA UTILITIES COMMISSION

Patricia Swenson

Patricia Swenson, Deputy Clerk

Commissioner William T. Culpepper, III, concurs in this decision.
Commissioner Robert V. Owens, Jr., joins in Commissioner Culpepper's concurrence.
Commissioners Bryan E. Beatty and Susan W. Rabon did not participate in this decision.

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Commissioner William T. Culpepper, III, concurring:

In its Motion For Reconsideration Duke has requested that the "Commission eliminate the condition limiting recovery of Program costs through the REPS rider to the third-placed solar bid; or, in the alternative 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's] execution of the Program." This Order On Reconsideration fully allows Duke the alternative relief it has requested in its motion. However, it is my belief that Duke is legally entitled to the relief that it has requested in the first instance, i.e. that the Commission eliminate the condition limiting recovery of Program costs through the REPS rider to the third-placed solar bid.

Simply put, the Commission has granted Duke's application for a Certificate of Public Convenience and Necessity to implement its proposed solar photovoltaic distributed generation program and to construct the associated generating facilities. The purpose of Duke's program is compliance with the solar energy resources requirements set forth in G.S. 62-133.8(d). G.S. 62-133.8(h)(4) states: "An electric power supplier shall be allowed to recover the incremental costs incurred to comply with the requirements of subsections … (d) … of this section … through an annual rider …" (emphasis supplied). Duke has requested full recovery of its Program costs via the REPS rider and I am of the belief that it is statutorily entitled to what it requests.

Nonetheless, in its motion Duke has phrased its requested relief in alternative terms, indicating that it will be satisfied if it is allowed to recover only a portion of its Program costs via the REPS rider, so long as it may recover the balance thereof in base rates. Indeed, this Order states that Duke has "agreed that this limitation is acceptable."[1] Notwithstanding Duke's having "agreed" to alternative relief, if this docket was mine alone to decide, circumstances are such that I would grant Duke the relief it has requested in the first instance and to which it is statutorily entitled.

However, this docket is before four members of the Commission, two of whom have reached the opinion that Duke should be granted the alternative relief to which it has "agreed", rather than full recovery of Program costs under the REPS rider. Despite my difference of opinion in this regard, I have elected to concur with the decision of my fellow Commissioners for reasons hereinafter stated.

First, this order causes retention of more headroom under the REPS cost cap provisions of G.S. 62-133.8(h)(4) for additional renewable energy projects than would

[1] See page 5. Of course, the circumstances leading one to "agree" to something can vary from pure volition to extreme duress. This Commission has placed Duke under some duress in this docket by virtue of improvident provisions contained in its December 31, 2008 Order Granting Certificate which are withdrawn by this Order On Reconsideration.

otherwise occur if all incremental costs of Duke's program were allowed to be recovered under the REPS rider.

Second, and more important, if neither Commissioner Owens nor I were to concur with the decision of our fellow Commissioners, the resulting 2-2 split would effectively deny Duke's Motion For Reconsideration and leave in place the Commission's December 31, 2008 Order Granting Certificate of Public Convenience and Necessity With Conditions. This would be untenable.

The Commission is unanimous in its opinion that the certificate it has granted Duke hereby has been justified by the public convenience and necessity. Duke has a solar energy resources requirement with which it must comply beginning with calendar year 2010 pursuant to legislative mandate. The company must be allowed to proceed with construction of its solar project unimpeded by the improvident tax normalization and cost recovery limitation provisions contained in our December 31, 2008 order, and it is entitled to an opportunity to fully recover its Program costs. Because this Order comports with all of the foregoing, I concur therewith.

\s\ William T. Culpepper III
Commissioner William T. Culpepper III