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December 20, 2013

Ms. Gail Mount
Chief Clerk
North Carolina Utilities Commission
Fifth Floor, Room 5063
430 N. Salisbury Street
Raleigh, NC 27603

Re: Post Hearing Brief
In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities-2012
Docket E-100, Sub 136

Dear Ms. Mount:

Please find enclosed for electronic filing Renewable Energy Group's Post Hearing Brief to be filed in the above referenced docket.

Thank you for your assistance with regard to this matter. If you have any questions concerning this submission, please do not hesitate to contact me.

Regards,

/s/ Charlotte A. Mitchell

Enclosures

M. Gray Styers, Jr.
Karen M. Kemerait
Charlotte A. Mitchell

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-100, SUB 136

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of: Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities - 2012	**POST HEARING BRIEF OF THE RENEWABLE ENERGY GROUP**

NOW COMES the Renewable Energy Group ("REG"), by and through its undersigned attorney, and respectfully submits this post hearing brief in the above-captioned docket regarding the biennial proceeding held by the North Carolina Utilities Commission (the "Commission") pursuant to Section 210 of the Public Utility Regulatory Policy Act of 1978 ("PURPA") and the regulations of the Federal Energy Regulatory Commission (the "FERC").

BACKGROUND

Indisputably, section 210(a) of PURPA requires incumbent electric utilities to offer to purchase the electrical output of cogenerators and small power producers, collectively referred to "Qualifying Facilities" or "QFs." Section 210(b) of PURPA makes clear that the rates for such purchases must be just and reasonable to the customers of the utilities, in the public interest, and must not discriminate against QFs. PURPA specifies that the rates for such purchases must not exceed the incremental cost to the utility of alternative electric energy, which is defined in section 201(d) as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." Put another way, the rates should reflect the costs to a utility that are avoided by obtaining energy and capacity from QFs. The FERC adopted a full-avoided-cost-rule when it implemented PURPA. See 18 C.F.R. § 292.101(b)(6). The United States Supreme Court upheld this full-avoided-cost-rule as "just and reasonable to the electric consumers of electric utilities and in the public interest," 16 U.S.C. § 824a-3(b); 18 C.F.R. § 292.304(a), because: 1) unlike electric utilities, QFs are not guaranteed a rate of return on their investments; 2) payment of full avoided costs will not result in increased rates for consumers and ratepayers; and 3) "ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." Am. Paper Inst., Inc. v. Am. Elec. Power Serv. Corp., 461 U.S. 402, 414-15 (1983) (citing 45 Fed. Reg. 12,214, at 12,222).

The requirement that the rates offered to the QF reflect the utility's full avoided cost is aimed at striking a balance between encouraging the development of QFs and ensuring a rate that is just and reasonable for the utility's customers. The members of REG—many of them QFs and others of them businesses that support QFs—have participated in this proceeding to ensure that this critical balance is struck. Contrary to what the utilities would have the Commission believe, the members of REG are neither asking the Commission to establish rates "that provide a financial windfall to QFs" [Tr. vol. 1, p. 99, ll 18-19] nor suggesting "that the Commission take steps to increase the rates to be paid to QFs to levels well above the Utilities' avoided costs." [Tr. vol 1, p. 99, l. 22 through p. 100, l. 1] Rather, REG's participation reflects the fact that the companies depend on the rates established in this proceeding to finance QFs in North Carolina that will: 1) generate power using renewable energy resources, thereby achieving the objectives of PURPA and Senate Bill 3; 2) facilitate the utilities' compliance with Senate Bill 3; and 3) provide critical job creation, capital investment, and economic development.

As discussed in the testimony of Public Staff witness Hinton, the rates proposed by the utilities in this docket, including both the energy credits and the capacity credits, were significantly reduced from those approved in the previous biennial proceeding. [Tr. vol. 3, p. 41, l. 18 through p. 42, l. 13; vol. 3, p. 45, ll 3-19] Irrespective of the testimony of DEC/DEP witness Bowman that the "price of fuel" is the largest driver for the decline in avoided cost rates from 2010 to 2012, [Tr. vol. 3, p. 209, ll 16-19] , the capacity credit declined precipitously, as well, as pointed out by Public Staff witness Hinton. [Tr. vol. 3, p. 83, ll 1-11] The impact of those rates on the development of renewable energy resources would have been grave. It was the reasonable desire to ensure that the appropriate balance was struck, not an unreasonable desire to profiteer, that necessitated REG's participation in this proceeding.

Given the settlement of REG on the avoided energy and capacity costs with Dominion North Carolina Power ("DNCP"), Duke Energy Carolinas, LLC ("DEC") and Duke Energy Progress, Inc. ("DEP"), this post-hearing brief sets forth the position of REG and associated requests for relief on the issues of: 1) increasing performance adjustment factor ("PAF") for wind and solar;[1] 2) striking the regulatory disallowance provision from the DNCP standard contract; 3) striking the reduction in contract energy

[1] It should be noted that DNCP and REG settled on both capacity cost as well as the rates proposed by DNCP under an "Option B" approach, as reflected in that Stipulation of Settlement between Dominion North Carolina Power and the Renewable Energy Group, filed on October 30, 2013 in this docket.

charge from the DEP standard contract; and 4) directing the utilities to make fixed rates available during the pendency of the biennial avoided cost proceeding, per the recommendation of the Public Staff.[2]

REQUESTS FOR RELIEF

1. **A Performance Adjustment Factor of 2.0 should be utilized by DEC and DEP in their respective avoided cost calculations for hydroelectric facilities with no storage capability and for wind and solar generation.**

The use of a PAF in the calculation of avoided cost rates when using the peaker methodology is a long standing tradition in North Carolina. In short, the PAF accounts for the fact that the QF, like any generating facility, cannot be in operation at all times. The use of the PAF in calculating rates "allow[s] a QF to experience a reasonable number of outages and still receive total payments equal to the utility's avoided costs." Order Establishing Standard Rates and Contract Terms for Qualifying Facilities, N.C.U.C. Docket No. E-100, Sub 106, December 19, 2007 ("2006 Order"), p. 17. Contrary to the fact that the utilities, in the instant proceeding, characterize PAF as an "additional payment on top of avoided costs," as an "adder to the capacity payment" [Tr. vol. 1, p. 122, ll 5-12], or as an "adder that exceeds the avoided cost," [Tr. vol. 1, p. 123, ll 22-23], this Commission has explained, in the context of discussing a higher PAF for hydro facilities, that:

> The use of a higher performance factor for these hydro facilities does not exceed avoided costs; **it simply changes**

[2] REG draws the Commission's attention to the fact that Section 2 of DEC's Standard Purchased Power Agreement addresses the rate schedule and service regulations. See Duke Energy Carolinas, LLC, Initial Statement and Exhibits, Exhibit 5, Docket No. E-100, Sub 136, filed November 1, 2012. DEC/DEP witness Bowman proposed language to be added to Section 2 to address the concerns raised by REG. [Tr. vol. 3, p. 127, ll 9-13] REG accepts this proposal and respectfully requests that the Commission, in its final order, direct DEC to amend Section 2 accordingly.

> **the method by which avoided costs are paid**. It allows these QFs to operate less in order to receive the full capacity payments to which they are entitled, and this seems reasonable and appropriate considering the limitations on their control of their generation.

Order Establishing Standard Rates and Contract Terms for Qualifying Facilities, N.C.U.C. Docket No. E-100, Sub 79, June 19, 1997, p. 19. Thus, the PAF is not an "adder" but rather the PAF simply "changes the manner in which avoided costs are paid." [Tr. vol. 1, p. 124, ll 6-15] In spite of the characterization by DEC and DEP of PAF as an "adder that exceeds avoided cost," DEP's predecessors have previously acknowledged that, in the context of a 2.0 PAF for hydro, the use of such a PAF does not result in the payment to hydro QFs of more than the utility's avoided cost. [Tr. vol. 1, p. 138, l. 10 through p. 139, l. 4] The PAF is not, as DEC/DEP would have the Commission believe, an arbitrary "adder," rather it is simply a mechanism that changes the manner in which the avoided costs are paid to the QF and gives the QF a better opportunity to earn the full capacity credit to which it is entitled.

In the last eight avoided cost proceedings, the Commission has ordered that a PAF of 2.0 be utilized by both DEC and DEP in their respective avoided cost calculations for run-of-river hydro and that a PAF of 1.2 be utilized by DEC and DEP for non-hydro facilities. See, e.g., Order Establishing Standard Rates and Contract Terms for Qualifying Facilities, N.C.U.C. Docket No. E-100, Sub 127, July 27, 2011 ("2010 Order"), Ordering Paragraph 7. In doing so, the Commission has noted that setting the PAF at 2.0 for run-of-river hydro QFs, "allow[s] such hydro QFs to collect their full capacity payments if they operate 50% of the time." 2006 Order, p. 17. Similarly, the Commission has noted that setting the PAF at 1.2 for non-hydro QFs "allow[s] such non-hydro QFs to receive payment for the utility's full avoided costs if they operate 83% of the time." 2006 Order, p. 17.

The Commission explained the reason for the 2.0 PAF for run-of-river hydro in the 2006 biennial proceeding, in detail, as follows:

> The actual reason for using a 2.0 PAF for run-of-river hydro QFs has been that doing so allows them to receive **the full capacity payments to which they are entitled while operating under the constraints created by their stream flows.** As the Public Staff witnesses pointed out, using a 2.0 PAF places run-of-river hydro QFs on an equal footing with run-of-river hydro generating facilities included in the rate base of the State's utilities, which are able to cover the full costs of these facilities. With respect to solar and wind QFs, however, this comparison has no relevance, because the State's utilities have no solar or wind facilities in rate base. On the other hand the Commission agrees that solar and wind QFs, like run-of-river facilities, have no control over their energy sources. This is a legitimate argument for treating them in the same manner as run-of-river hydro QFs.

2006 Order, p. 20. In the 2006 proceeding, Public Staff recommended that solar and wind QFs receive a 2.0 PAF based on the variability of the resources. Proposed Order of the Public Staff, N.C.U.C. Docket No. E-100, Sub 106, September 19, 2007, p. 19. Public Staff correctly pointed out once Senate Bill 3 is in effect and "REPS is in operation, the market for renewable energy in North Carolina is likely to change dramatically, and in future cases, issues relating to PAF will be presented in an entirely new context" and noted that, therefore, any decision reached by the Commission in that docket would be "in the nature of an interim decision." Id., p. 20. Ultimately, the Commission concluded that the issue should be further addressed in subsequent proceedings after assessing the impact of Senate Bill 3. 2006 Order, p. 22. In the last two biennial proceedings, no party proposed any changes to the use of PAFs. As forecasted by Public Staff and the Commission in the 2006 proceeding, the time is ripe in this proceeding for the Commission to revisit applying a 2.0 PAF to solar and wind QFs.

First, it remains the case that solar and wind QFs, like run-of-river facilities, have no control over their energy sources and no storage capability. This creates a significant disadvantage for solar and wind QFs since none of the utilities offers capacity credit during off-peak hours. This means that QFs that rely on variable resources will receive only the energy credit of the avoided cost rate for the power produced during the off-peak hours. However, utilities recover, through rates, the full cost of their generating facilities regardless of when those facilities produce power and how much power they produce. By way of illustration, the capacity cost of a peaker that sits idle 11 months out of the year is fully recovered by the utility by its inclusion in rate base.

Second, as noted by the Commission in the 2006 Order, a 2.0 PAF places run-of-river hydro QFs on an equal footing with run-of-river hydro facilities included in the rate base of the State's utilities, which are able to cover the full costs of these facilities. <u>2006 Order</u>, p. 20. The Commission noted that, with respect to solar and wind QFs, this comparison had no relevance because the utilities had no solar or wind facilities in rate base at that time. <u>2006 Order</u>, p. 20. Since the 2006 proceeding, DEC has added solar generating facilities to its rate base. [Tr. vol. 1, p. 130, l. 2] The capacity factor of DEC's solar facilities is approximately eighteen percent (18%). [Tr. vol. 1, p. 130, ll 10-11] Pursuant to the retail rate making process, DEC is entitled to recover the full cost of these solar facilities. DEC ascribes a similar capacity factor to non-utility solar generating facilities in its IRP. [Tr. vol. 1, p. 131, 11-17] Although the utility recovers its costs though a different regulatory mechanism than the QF, a utility is entitled to recover the full cost of its own solar facilities while it is not possible for a solar QF to recover the full payment to which it is entitled. Treating identical generating facilities differently is unfair and unreasonably discriminates against the non-utility solar.

Third, like run-of-river hydro QFs, solar and wind QFs have no control over their energy sources. And, as the Commission has previously noted, "[t]his is a legitimate argument for treating them in the same manner as run-of-river hydro QFs." DEC has solar generation facilities in rate base. And, as the Commission has previously noted, using a 2.0 PAF places QFs on an equal footing with identical facilities included in the rate base of the utilities.

Fourth, even if the PAF is increased to 2.0 for non-hydro facilities, while this increase will give the QFs a better opportunity to earn the full capacity credit to which they are entitled, solar and wind QFs, like hydro QFs, **still will not be able to earn the full capacity credit to which they are entitled** as they cannot provide an equivalent of 50% of their output during the designated on peak hours, due to the operating constraints of variable energy resources. Therefore, even a PAF of 2.0 would not remedy the fact that a QF that relies on a variable resource likely will not earn the full capacity credit to which it is entitled.

Fifth, again, contrary to the claim of DEC and DEP that REG is seeking an increased PAF merely in the interest of profit,[3] even if the Commission approved a PAF of 2.0 for solar and wind QFs, the rates available to the QFs will still be lower than those

[3] At the public hearing held in this docket on February 12, 2013, Michael Shore, on behalf of FLS Energy, testified regarding the profit margin of the typical solar QF and indicated that, in the context of a 2 MW facility developed by his company, it took five years for the company to break even. [Public Hearing Tr. vol. 1, p. 26, ll 20-24] John Morrison, on behalf of Strata Solar, provided testimony that even the most efficiently developed utility scale projects, which benefit from certain economies of scale, produce only thin profit margins. [Public Hearing Tr. vol. 1, p. 14, ll 12-18]

approved by the Commission in the 2010 proceeding, as confirmed by REG witness Reading. [Tr. vol. 2, p. 62, ll 5-9]

Finally, it is worth noting that, like the Public Staff and the utilities, REG recognizes that an "Option B" approach—the payment of increased capacity credits over a shorter range of hours—is an alternative approach to the payment of rates and, conceptually, has the potential to incent the QF to put power to the utility when most in need, to a mutually beneficial end. To this end, REG settled with DNCP on the Option B approach proposed by the company, as it was determined by REG that the DNCP Option B did, in fact, provide a better opportunity to earn the full capacity credit to which the QF is entitled.

In explaining the "Option B" approach, DEC/DEP witness Bowman testified as follows:

> Q: So there are additional payments made to the QF under Option B?
>
> A: Yes. There is an increase to the QF under Option B than what we originally proposed.

[Tr. vol. 1, p. 154, ll 5-8] However, the "Option B" approach does not necessarily result in "additional payments" to the QF but rather could result in less payment to the QF. While the "Option B" approach involves increased capacity credits, these credits are offered over a shorter period of time—fewer hours—than under the "Option A" approach. If the period of time includes hours during which the QF may not be in operation, due to the operating constraints of variable energy resources, the practical effect may be that, since the QF earns capacity credits over an even more limited number of hours, this reduction in hours is not offset by the increase in the capacity credit. While, in theory, the purpose of the "Option B" is "to provide an opportunity for QFs to have a better opportunity to earn the capacity credit to which it is entitled," the limited number of hours does not equate—necessarily—to a better opportunity to earn the full capacity credit to which the QF is entitled. [Tr. vol. 3, p. 90, ll 6-15]

2. Article 6 of DNCP's Agreement for the Sale of Electrical Output to Virginia Electric and Power Company Is Inconsistent with PURPA and Must Be Struck.

Article 6 (the "Regulatory Disallowance Provision") of DNCP's Agreement for the Sale of Electrical Output to Virginia Electric and Power Company addresses a situation in which a regulatory body with jurisdiction, such as this Commission or the Virginia State Corporation Commission, issues an order that disallows the recovery by the utility of payments previously made to a QF or to be made to a QF in the future (a "Disallowance Order"). In the event of a Disallowance Order, the Regulatory Disallowance Provision: 1) requires a QF to accept, from the effective date of the order, payments that are reset at new rate levels that will be allowed to be recovered; and 2) requires a QF to refund to DNCP i) sums related to payments previously made to QFs that are disallowed from recovery, as well as ii) any sums related to payments previously made to QFs that are disallowed from recovery and that DNCP is ordered to refund to customers. See Article 6: Regulatory Pricing Adjustment and Refund, Agreement for the Sale of Electrical Output to Virginia Electric and Power Company, Dominion's Corrected Comments, Exhibits and Avoided Cost Schedules, Exhibit DNCP – 13, N.C.U.C. Docket No. E-100, Sub 136, filed November 5, 2012. DNCP witness Trexler points out that, pursuant to the Regulatory Disallowance Provision, "if a Disallowance Order requires [DNCP] to refund to ratepayers previous payments to a QF, then the QF is similarly required to refund to [DNCP] those amounts." [Tr. Vol. 3, p. 214, ll 16-18] However, the Regulatory Disallowance Provision goes beyond this by requiring a QF to refund to DNCP any sums previously paid to QFs that DNCP is prohibited from recovering, regardless of whether the Disallowance Order requires a refund. The Regulatory Disallowance Provision is inconsistent with PURPA and should be struck for the reasons set forth below.

a. The Regulatory Disallowance Provision is inconsistent with a QF's right to a fixed price over the term of the contract.

The Regulatory Disallowance Provision is inconsistent with the clear and unambiguous right of the QF, set forth in 18 C.F.R. § 292.304(d)(2), to fixed rates over the term of the power purchase agreement. As has been stated by the FERC, the "[FERC]'s regulations, from the beginning, have given QFs the option of choosing to have rates calculated at the time the obligation is incurred. The intention of the [FERC] was to enable a QF 'to establish a fixed contract price for its energy and capacity at the outset of its obligation.' " See Order Denying Requests for Rehearing, Reconsideration or Clarification, Docket No. EL09-77-001, 130 FERC ¶ 61,127 at 10, Feb. 19, 2010 (quoting Order No. 69, FERC Stats. & Regs. ¶ 30,128 at 30,880). In support of establishing the right of a QF to a fixed rate, the FERC has recognized that " 'to be able to evaluate the financial feasibility of a [QF], an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction. . . .' " Id. (quoting Order No. 69, FERC Stats. & Regs. ¶ 30,128 at 30,868). Thus, Regulatory Disallowance Provision is inconsistent with both the clear terms of the regulation, as well as subsequent proclamation by the FERC, regarding the QF's right to a fixed rate and undermines the basis for that right by depriving an investor of certainty as to expected return.

Notably, this Commission has previously rejected a contract provision that would have allowed existing standard contracts for QFs to be amended as the result of subsequent governmental or judicial action. See Recommended Order (of Hearing Examiner), N.C.U.C. Docket No. E-100, Sub 41, April 1, 1983, aff'd Order, June 3, 1983. In short, the Hearing Examiner rejected the utility's proposed contract language, stating that the proposed language "cast[s] such uncertainty on the stability of the standard contract that it will be difficult, if not impossible, for small power producers to obtain long-term financing." Id.

b. The risk of a Disallowance Order in the context of Commission-approved rates is too remote to justify inclusion of the Regulatory Disallowance Provision.

The rates at issue in this proceeding will be reviewed and approved by the Commission, which is bound by federal law and regulation to establish rates that reflect nothing more than the utilities' full avoided cost. See 18 C.F.R. § 292.304. Therefore, the possibility of a Disallowance Order is remote. DNCP witness Trexler acknowledged that the Commission's express approval of the rates at issue in this proceeding lessens the risk that DNCP will be subject to a Disallowance Order. Specifically, Trexler testified that "[DNCP] believes the possibility of a Disallowance Order is remote under existing law and precedent." [Tr. vol. 3, p. 216, ll 17-20; p. 218, ll 3-4] In fact, DNCP cites legal precedent for the proposition that once a regulatory authority has approved a power purchase agreement involving rates that it has found to be consistent with the utility's avoided cost, it may not then disapprove passage of those costs onto ratepayers, and any attempt by the commission to do so would be preempted by federal law. [Tr. vol. 3, p. 217, ll 1-7; see also Freehold Cogeneration Associates v. Bd. Of Regulatory Commissioners of New Jersey, 44 F. 3d 1178, 1194 (3d Cir. 1995)]

DNCP witness Trexler maintains that, despite this clear legal precedent that would preclude a regulatory authority from disapproving rates that it had previously approved, "the possibility still exits that rates approved by one regulatory body could be rejected by another regulatory body." [Tr. vol. 3, p. 217, ll 8-9] It should be noted, however, that both DEP and DEC, like DNCP, are subject to the regulatory oversight of multiple state regulatory bodies, yet neither DEC nor DEP includes an analogous provision in the standard contract.

DNCP cites two instances in which the company was subject to a Disallowance Order. These two instances are factually distinguishable from the instant proceeding and, for this reason, merit discussion. The first instance involves an order issued by this Commission, disallowing recovery from DNCP's North Carolina ratepayers a portion of payments made by DNCP to several QFs (the "North Carolina Disallowance Order"). State ex rel. Utilities Com'n v. North Carolina Power, 450 S.E.2d 896, 900, 338 N.C. 412, 420 (1994), cert. denied, 516 U.S. 1092 (1996) ("Utilities Com'n v. DNCP"). The North Carolina Disallowance Order was based on a determination by the Commission that the rates paid to the QFs exceeded DNCP's avoided cost. The contracts at issue in the North Carolina Disallowance Order involved several cogeneration QFs located in Virginia (the "Ultra Cogen Facilities"). In 1986, DNCP had instituted a competitive solicitation process for QFs, in response to which DNCP received proposals for the Ultra Cogen Facilities. Utilities Com'n v. DNCP, 450 S.E.2d at 898, 338 N.C. at 416. DNCP rejected the proposals for the Ultra Cogen Facilities "[b]ased on numerous factors, including cost," and Ultra Cogen initiated arbitration proceedings with the Virginia State Corporation Commission ("VSCC") seeking to arbitrate DNCP's rejection of the proposals. Id. The arbitrator specified the terms and conditions of the PPAs, including the capacity payment for each year of the twenty-five year term, and ordered DNCP to enter into the contracts. Utilities Com'n v. DNCP, 450 S.E.2d at 900, 338 N.C. at 419. This Commission, in entering an order on an application for a rate increase by DNCP, denied recovery of a portion of the costs incurred as a result of the Ultra Cogen contracts. The capacity cost ordered by the arbitrator was 2.4 times greater than the capacity cost that resulted from previous competitive solicitations conducted by DNCP in the same year and just two years earlier. Utilities Com'n v. DNCP, 450 S.E.2d at 900, 338 N.C. at 420. In issuing the North Carolina Disallowance Order, the Commission had compared the Ultra Cogen contracts to the results of the competitive solicitations to determine that the rates offered under the contracts "greatly overestimated" DNCP's cost. Utilities Com'n v. DNCP, 450 S.E.2d at 900, 338 N.C. at 420. The circumstances that resulted in the North Carolina Disallowance Order—capacity costs greatly overestimated by an arbitrator—are distinguishable from those of the instant proceeding in which the Commission retains approval authority over the capacity costs underlying the rates.

The second instance involved a disallowance order issued by the VSCC (the "Virginia Disallowance Order"). Similar to the North Carolina Disallowance Order, the facts underlying the Virginia Disallowance Order are distinguishable from the instant proceeding. The Virginia Disallowance Order pertained to 58 power purchase agreements entered into by DNCP with QFs that were **not eligible for the standard**

rates approved by the VSCC. Hopewell Cogeneration Ltd. Partnership v. State Corp. Com'n, 453 S.E.2d 277, 249 Va. 107 (1995) ("Hopewell v. VSCC"). The VSCC determined that amounts based on gross receipts tax ("GRT") were improperly included in DNCP's avoided cost calculation, as DNCP GRT liability could not be avoided by purchasing from a QF. The VSCC determined that these amounts were "unnecessary and excessive" and disallowed recovery of those amounts by DNCP. Hopewell v. VSCC, 453 S.E.2d at 280, 249 Va. at 113. The VSCC declined to extend the finding to any contracts that had been reviewed and approved by the VSCC or the FERC. Id. In upholding the Virginia Disallowance Order, the Virginia court refused to compare the standard rates to the negotiated rates between DNCP and the non-utility generators, noting that such comparison is not probative of the utility's avoided cost or the reasonableness of the individually negotiated contracts at hand. Id., 453 S.E.2d at 282, 249 Va. at 115.

Therefore, the two cases in which DNCP has been subject to regulatory disallowance orders involve non-standard, negotiated and arbitrated contracts, which are materially distinguishable from the standardized rates at terms, which are subject to Commission scrutiny and oversight, in this proceeding. Therefore, the fact that DNCP has twice been subject to a disallowance order is not justification for the inclusion of the Regulatory Disallowance Provision in DNCP's standard contract.

c. Evidence in the record from this proceeding demonstrates that the Regulatory Disallowance Provision discourages QF development.

As evidence in the record for this proceeding demonstrates, the Regulatory Disallowance Provision discourages QF development. As pointed out by REG witness Morrison, Morrison's own firm, Strata Solar, has attempted to finance projects in DNCP territory and has been unsuccessful in doing so because of the Regulatory Disallowance

Provision. [Tr. vol. 2, p. 116, ll 11-13; p. 132, ll 8-10] In spite of avoided cost rates that are preferable to the other utilities, Strata has been unable to convince a lender to finance a solar project in DNCP service territory. [Tr. vol. 2, p. 136, 12-16]

Strata's experience is consistent with that of Ecoplexus, Inc., a solar developer based in California that is attempting to develop solar facilities in North Carolina. As REG affiant Erik Stuebe stated, Ecoplexus has attempted to secure debt financing for solar facilities under development in DNCP territory. [Tr. vol. 3, p. 106, ¶ 5] The lenders from whom financing was sought have financed more than $100 million of solar generation projects, including an Ecoplexus project in another state. [Tr. vol. 3, p. 107, ¶ 6] Both of these lenders have declined to provide financing for Ecoplexus' projects in DNCP service territory, because of the Regulatory Disallowance Provision. [Tr. vol. 3, p. 107, ¶ 7] As Morrison testified and Stuebe averred, the Regulatory Disallowance Provision makes obtaining financing for a QF in DNCP territory impossible. [Tr. vol. 2, p. 130, ll 5-9; vol. 3, p. 107 ¶ 8]

DNCP points out that two affiliates of Strata Solar filed applications for CPCNs for solar facilities in DNCP service territory and that the company "has been in discussions" with DNCP concerning the development of a larger solar facility in DNCP service territory. [Tr. vol. 3, p. 222, ll 19-20; p. 223, ll 1-3] In addition, DNCP suggests that the applications for CPCNs that have been filed in 2013 for projects in DNCP service territory indicate that the Regulatory Disallowance Provision does not discourage QF development. [Tr. vol. 3, p. 223, ll 13-16] However, as explained by Morrison, the display of interest in developing projects in DNCP service territory reflects the "optimism of an entrepreneur." [Tr. vol. 2, p. 139, ll13-14] Morrison further explained that Strata

Solar, like other QF developers, "as an entrepreneurial organization . . . lives in a world of optimism and expect[s] and hope[s] for a favorable outcome" in this proceeding. [Tr. vol. 2, p. 139, ll17-19] The CPCN applications reflect that fact that QF developers are "creating a pipeline so that in the event things go [their] way, [they] can be ready to move." [Tr. vol. 2, p. 139, ll19-21]

In support of its position that the Regulatory Disallowance Provision does not discourage QF development, DNCP witness Trexler testified that DNCP has entered into five standard contracts with QFs in the last two years. [Tr. vol. 3, p. 223, ll 7-8] Trexler also testified that three of these QFs have entered commercial operation and two have started construction. [Tr. vol. 3, p. 223, ll 8-9] Two of those QFs are biomass facilities: 1) W.E. Partners I, LLC, which has a nameplate capacity of 100 kW; and 2) W.E. Partners II, LLC, which has a nameplate capacity of 300 kW. [DNCP Exhibit filed in N.C.U.C. Docket No. E-100, Sub 136 on November 26, 2013] Of these two biomass QFs, only W.E. Partners II, LLC appears in Appendix 3B-Other Generation Units-to DNCP's 2012 Integrated Resource Plan, filed in N.C.U.C. Docket No. E-100, Sub 137, which lists other generation units that make up DNCP's supply side resources. As set forth in Appendix 3B, W.E. Partners II, LLC, a 300 kW biomass facility, is listed as being in operation as of June 1, 2012.

The remaining three QFs referred to by DNCP witness Trexler are solar facilities: 1) Plymouth Solar, LLC, which has a nameplate capacity of 5 MW; 2) Tier One Solar, LLC, which has a nameplate capacity of 1.8 MW; and 3) 510 REPP One, LLC, which has a nameplate capacity of 1.25 MW. [DNCP Exhibit filed in N.C.U.C. Docket No. E-100, Sub 136 on November 26, 2013] Of these three solar facilities, only Plymouth Solar, LLC appears in Appendix 3B-Other Generation Units-to DNCP's 2012 Integrated Resource Plan, filed in N.C.U.C. Docket No. E-100, Sub 137, and is identified as a "pending" resource.

A review of Appendix 3B-Other Generation Units-to DNCP's 2013 Integrated Resource Plan, filed in N.C.U.C. Docket No. E-100, Sub 137, indicates that W.E. Partners II, LLC, W.E. Partners I, LLC and Plymouth Solar, LLC are in operation.

Neither Tier One Solar, LLC, nor 510 REPP One, LLC is listed in Appendix 3B as being in operation. DNCP provides no evidence that these two facilities are under construction, other that DNCP witness Trexler's testimony that he believes them to be. A review of the public record revealed no building permit for either of these facilities. Moreover, industry convention suggests that these two QFs likely may not be developed. A review of the public record reveals that a CPCN was issued for 510 REPP One, LLC on August 15, 2012, N.C.U.C. Docket No. SP-804, Sub 1, and for Tier One Solar, LLC on April 11, 2013, N.C.U.C. Docket No. SP-2401, Sub 1. As pointed out by Public Staff witness, solar QFs, relative to other types of power generation facilities, have a short construction window. [TR vol. 3, p. 22, ll 10-12; p. 75, ll 8-17] As testified by REG witness Morrison, the development process for a 5 MW solar QF is approximately six (6) to 12 months, and the construction process takes three (3) months. [TR vol. 2, p. 126, ll 1-5] Presumably, if these facilities were going to be developed to commercial operation, they would be in operation (or at least indicated as "pending" resources, as Plymouth Solar was in 2012) as of the date of the 2013 DNCP IRP.

DNCP offered no evidence that any of these QFs were financed by investors. In fact, while DNCP witness Trexler recalled having conversations with lenders for two of the five QFs, he ultimately acknowledged that he does not know how these QFs were financed, [Tr. vol. 3, p. 268, ll 1-17; p. 267, l. 4], and DNCP offered no other evidence to demonstrate that investors were involved in these QFs. Moreover, the size of two of these QFs—100 kW and 300 kW—raise the issue of whether investor funds were necessary to develop the facilities.

The five (5) QFs referenced by DNCP witness Trexler—only three (3) of which actually have been constructed and placed in service—stand in stark contrast to the two hundred and twenty-two (222) projects that have been developed and are operational as of October 2013 in DEC and DEP service territory since January 1, 2011. [Duke Energy Carolinas, LLC and Duke Energy Progress, Inc.'s Revised Late-Filed Exhibit, filed in N.C.U.C. Docket No. E-100, Sub 136 on December 2, 2013] Notably, neither the standard contract of DEC nor the standard contract of DEP includes a provision analogous to or even similar to the Regulatory Disallowance Provision.

As DNCP witness Trexler pointed out, in the previous biennial determination of avoided cost rates, N.C.U.C. Docket No. E-100, Sub 127, (the "2010 Proceeding") the Commission concluded, "[b]ased on the record in [that] proceeding" that DNCP's inclusion of a regulatory disallowance clause in its standard contract was reasonable and should be allowed. <u>Order Establishing Standard Rates and Contract Terms For Qualifying Facilities</u>, N.C.U.C. Docket No. E-100, Sub 127, July 27, 2011 ("<u>2010 Order</u>"), p. 22. In the <u>2010 Order</u>, the Commission noted the following:

> With respect to the Public Staff's position assertion that the Regulatory Disallowance Clause is "likely to discourage QF development," NC Power noted that nothing in the record of this proceeding supports that assertion.

2010 Order, p. 21. Unlike the record in the 2010 Proceeding, the record in the instant proceeding includes competent, material and substantial evidence demonstrating that the Regulatory Disallowance Provision discourages QF development. Both REG witness Morrison and REG affiant Stuebe have provided evidence that the Regulatory Disallowance Provision has been a barrier to financing QFs in DNCP service territory. [Tr. vol. 2, p. 116, ll 11-13; vol. 2, p. 132, ll 8-10; vol. 2, p. 136, 12-16; vol. 3, p. 106, ¶ 5; vol. 3, p. 107, ¶ 6; vol. 3, p. 107, ¶ 7] Additionally, the fact that 222 QFs have been developed and are in operation in DEC and DEP service territories over the last two years, while only three (3) QFs have been developed and are in operation in DNCP, is compelling support for REG's position.

d. Shifting the entire burden of a Disallowance Order to the QF has no basis in PURPA, is inconsistent with existing precedent, and should not be tolerated by this Commission.

DNCP takes the position that "there is no principled reason or basis in PURPA for the Commission to impose the entire burden of a Disallowance Order on [DNCP] and its shareholders. . . ." [Tr. vol. 3, p. 222, ll 2-5] However, as pointed out by DNCP witness Trexler, as a result of the Regulatory Disallowance Provision, the "entire burden is shifted back to the QF. . . ." [Tr. vol. 3, p. 264, ll 3-4] As discussed below, Regulatory Disallowance Provision is inconsistent with existing precedent and, for this reason, must be struck.

DNCP cites the Freehold decision as support for its position that the risk of a disallowance order is remote because a commission cannot upset contract rates or terms that it had previously approved. Freehold Cogeneration Associates v. Bd. Of Regulatory Commissioners of New Jersey, 44 F. 3d 1178 (3d Cir. 1995). Freehold involves a "regulatory out" clause in a power purchase agreement, similar to the Regulatory Disallowance Provision. The Freehold court, in striking the clause, held that once the relevant state commission has approved a PPA on rates that it has found to be consistent with avoided cost, it may not then disapprove passage of those costs to ratepayer, and any attempt by the commission to do so would be preempted. The Freehold court also noted that such a contract provision is unnecessary as it "does not purport to confer on the [regulatory] body any jurisdiction it would not otherwise have" making the point that the regulatory body always has the authority to disallow recovery of costs deemed imprudently incurred by the utility – however, this risk is the utility's and cannot be shifted to the QF. Freehold, 44 F. 3d at 1194.

An analogous regulatory disallowance provision was struck from the standard offer contract of Florida Power & Light. Florida Power & Light v. Beard, 626 So.2d 660 (Florida 1993). In upholding the decision of the Florida Public Service Commission to strike the contract provision, the court noted that regulatory out clauses "create a mistaken perception that revenues under a standard offer contract are not reliable." Beard, 626 S0.2d at 663. Additionally, the Florida court noted the Florida Public Service Commission's guarantee that the utility would recover payments made under the standard offer, citing the commission's order which provided as follows:

> A significant difference between standard offer and negotiated contracts is that we require utilities to purchase firm capacity and energy pursuant to the standard offer contracts. The utilities are given no choice. Therefore, when we approve the standard offer contract, we make a commitment that we will allow cost recovery of payments made to small QFs.

Beard, 626 S0.2d at 662.

Finally, the Supreme Court of Oklahoma invalidated a requirement by state regulators that "regulatory out" clauses be included in contracts. Smith Cogeneration Management, Inc. v. Oklahoma Corp. Comm'r and Pub. Serv. Co. of Oklahoma, 863 P. 2d 1227 (1993). In doing so, the court held that these clauses conflict with the parties' rights to fixed rates over the term of the contract.

Thus, the Regulatory Disallowance Provision must be struck as it: a) is inconsistent with the QF's clear and unambiguous right to a fixed rate over the term of the contract; b b) is unnecessary given that the risk of a disallowance order in the context of the Commission-approved standard rates is too remote to justify its inclusion; c) creates a barrier to financing QF development, as indicated by evidence in the record; and d) is inconsistent with existing precedent.

3. The Reduction in Contract Energy Provision in Item 6 of the Terms and Conditions for the Purchase of Electric Power of Duke Energy Progress, Inc. is Unnecessarily Punitive and Must Be Struck.

Item 6 of DEP's Terms and Conditions for the Purchase of Electric Power addresses early contract termination as a result of changes in contracted-for capacity or energy. See TERMS AND CONDITIONS FOR THE PURCHASE OF ELECTRIC POWER, Progress Energy Carolinas, Inc., Initial Statement and Exhibits, Attachment 4, N.C.U.C. Docket No. E-100, Sub 136 ("DEP Terms and Conditions"). The subsection on the reduction in contract energy penalizes the QF if the "[s]eller's average energy generated in the on-peak or off-peak periods during any 12-month period falls below 80% of the Contract On-Peak or Off-Peak energy level." As indicated by REG witness Morrison, this contract provision creates uncertainty for investors. [Tr. vol. 2, p. 143, ll 12-14] Depriving investors of reasonable certainty as to the expected return on investment, is inconsistent with PURPA and conflicts with previous decisions of the FERC and this Commission. See Order on Arbitration, N.C.U.C. Docket No. SP-467, Sub 1, June 18, 2010, p.7. It is unnecessary, and DEP acknowledges as much. Specifically, DEP/DEC witness Bowman testified that DEP "has never had to resort to the Reduction-in-Contract-Energy-Charge to resolve a performance issue with a QF." [Tr. vol. 3, p. 134, ll 4-6]

In addition, the charge is unduly punitive for QFs that generate electricity using variable resources. DEP does not pay a QF unless electricity is generated by and received from the QF. Charging a small QF when production is off by 20% (or falls below 80%) unfairly enriches the electric utility at the expense of the QF. This is particularly unfair when the QF relies on variable resources—such as hydro, solar or wind—and causes hardship for the QF developer when attempting to access capital on reasonable, workable terms.

Finally, the Commission has previously held that while a utility could require a QF to provide the amount of capacity and energy it intended to provide, the utility could not later use that information against the QF punitively, particularly a QF that relies on a variable resource, without explicit order from the Commission allowing such action. Initial Statement of the Public Staff, N.C.U.C. Docket No. E-100, Sub 136, p. 30 (citing N.C.U.C. Docket No. E-100, Sub 59).

For these reasons, the subsection on reduction in contract energy charge should be removed from Item 6 of the DEP Terms and Conditions. It is worth noting that the DEC

Standard Contract does not contain an identical provision, which is an improvement in practice that DEP should be required to adopt.

4. **The Utilities Should Be Required To Make Rates Available to QFs Per the Recommendation of the Public Staff.**

In its Reply Comments filed in this docket, the Public Staff advocated that, for the same reasons the Commission concluded that DEP must offer approved rates to QFs that had timely filed applications for CPCNs of reports of construction, DEC's and DNCP's avoided cost tariffs should be revised such that fixed rates remain available to QFs. Specifically, the Public Staff recommended that: 1) the proposed new long-term avoided cost rates be made available, subject to true-up if the Commission approves higher rates, to QFs that have not filed their applications for CPCNs or reports of construction by the November 1 filing date of proposed rates; and 2) the approved long-term rate options be made available to QFs that have filed their applications for CPCNs or reports of construction by or on the November 1 filing date of proposed rates. Reply Comments, N.C.U.C. Docket No. E-100, Sub 136, March 28, 2013, pp 14-15. REG joins the Public Staff in advocating for the Commission to so establish this standard as it is ensures the QF's right to a fixed rate, as required by PURPA and is consistent with Commission precedent.

CONCLUSION

As every party to this proceeding has acknowledged, and the Commission is keenly aware, the renewable energy generation landscape in North Carolina has been is in the midst of transformation. This proceeding has highlighted the vastly different positions on whether this transformation is positive, progressive and exciting change or whether it is something to fear. The utilities' side of this story is this transformation is ominous—potentially disastrous for the utilities as well as for the ratepayers. Repeated reference has been made by the utilities to thousands of megawatts, hundreds of millions of dollars, and profiteering developers. However, the other side of the story is that North Carolina has benefitted from this transformation – in terms of deferred capacity additions, in terms of jobs creation, investment and economic development, in terms of the environmental benefits offered by renewable energy, and in terms of increased domestic energy production. Is the appropriate response to this transformation embracing the potential and working collaboratively in the interest of the benefits that have been and can be realized in North Carolina, or is the appropriate response to take action to suppress the transformative forces?

As DEC/DEP witness Bowman testified that "[a]s of March 28, 2013, there were over 1,650 MWs of proposed solar generation facilities and approximately 200 MWs of proposed wind facilities in the Utilities' interconnection queues. Since that time, the amount of solar and wind generation in the Utilities' transmission queues has grown to approximately 2,300 MWs and 300 MWs, respectively" [Tr. vol. 1, p. 105, ll 14-18] While these numbers are large and the queues have developed in a relatively short time, these numbers are not an accurate reflection of how much capacity will actually be developed. The utilities have acknowledged this fact. REG witness Morrison testified that the optimism and business model of the entrepreneur involve the development of project pipelines, in hopes that at least some of the pipeline will be developed. Thus, the utilities use these numbers, which, as they have acknowledged and which Morrison has explained, do not reflect what is likely to actually happen, to support their version of the transformation that is occurring in North Carolina – that it should be feared.[4]

Finally, the utilities have focused on cost to ratepayers and have claimed that any increase in payments made to QFs will result in tens of millions of dollars to be borne by the ratepayers. [Tr. vol. 1, p. 106, ll 9-20] However, it cannot and should not be ignored that QF generation benefits ratepayers. In fact, on cross-examination, DEC/DEP witnesses Bowman and Snider acknowledged as much. Specifically, DEC/DEP witness Snider, acknowledging that the addition of QF capacity was partially responsible for DEC's deferral of capacity need, testified as follows:

> . . . the first capacity need from the '11 IRP to the '12 IRP was shifted from 2015 to 2016 and is primarily due to lower forecasted load projections, an increase in the projected capacity and energy, **<u>purchases from qualified facilities pursuant to the requirements of PURPA 1978</u>**.

[Tr. vol 3, p. 181, ll 1-7] Deferred capacity additions translate to deferred rate increases. In addition, NCSEA witness Rabago testified at length as to the growing body of knowledge on the benefits solar generation generally and specifically as to North Carolina ratepayers. [Tr. vol. 2, p. 182, ll 8-24] Although the utilities would have the

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[4] The most significant indication that this queue does not reflect will be developed and put into service is the experience of DEC and DEP with QFs not eligible for the standard rates. While these numbers reflect the amount of capacity in the queues, these numbers do not reflect the QF capacity that is eligible for the standard rates. In fact, DEC/DEP witness Bowman indicated that, roughly fifty percent (50%) of this capacity is not eligible for standard rates because the proposed projects exceed 5 MW. [Tr. vol. 3, p. 192, ll 9] As evidenced by the DEC/DEP late-filed exhibit, the proposed solar capacity for projects greater than 5 MWs is more than 700 MWs. To date, merely two PPAs with such projects not eligible for the standard rates have been executed – one with Apple Inc. for a 20 MW solar facility and another with SunE DEC1 LLC for a 15.5 MW. Thus, the market appears to be dictating larger projects, as evidenced by the number proposed to date. In the interest of encouraging QF development and keeping administrative and transaction costs to a minimum for the utilities and QFs (as well as the Public Staff and this Commission), might it be the appropriate time to consider increasing the size of those projects eligible for the standard rates?

Commission believe otherwise, the Commission must keep in mind the benefits that QF generation has provided and will continue to provide to the ratepayers when deliberating on the issues presented in this proceeding.

In light of the foregoing, REG respectfully requests that the Commission:

1. Direct DEC and DEP to use a PAF of 2.0 when calculating avoided cost rates for wind and solar QFs;
2. Direct DNCP to eliminate the Regulatory Disallowance Provision from its standard contract;
3. Direct DEP to eliminate the reduction in contract energy charge from Item 6 in its Terms and Conditions; and
4. Direct the utilities to make fixed rates available to QFs subsequent to the filing of proposed rates per the recommendation of the Public Staff.

Respectfully submitted, this 20th day of December, 2013.

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CERTIFICATE OF SERVICE

It is hereby certified that the foregoing Post-Hearing Brief of the Renewable Energy Group has been served this day by hand delivery, electronic mail or by depositing copies of same in a depository under the exclusive care and custody of the United States Postal Service in postage prepaid envelopes and properly addressed to all parties of record.

This 20th day of December, 2013.

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