**McGuireWoods LLP**
434 Fayetteville Street
Suite 2600
PO Box 27507 (27611)
Raleigh, NC 27601
Phone: 919.755.6600
Fax: 919.755.6699
www.mcguirewoods.com
**Andrea R. Kells**
Direct: 919.755.6614

McGUIREWOODS

akells@mcguirewoods.com



September 3, 2014

**VIA ELECTRONIC FILING**

Mrs. Gail L. Mount, Chief Clerk
North Carolina Utilities Commission
Dobbs Building
430 North Salisbury Street
Raleigh, North Carolina 27603-5918

Re: Docket No. E-22, Sub 510

Dear Mrs. Mount:

Enclosed for filing in the above-referenced docket on behalf of Virginia Electric and Power Company, d/b/a Dominion North Carolina Power ("DNCP"), is the *Statement of Position of Dominion North Carolina Power*.

Should you have any questions please do not hesitate to contact me. Thank you for your assistance in this matter.

Very truly yours,

*s/Andrea R. Kells*

ARK:asm

Enclosures

**STATE OF NORTH CAROLINA**
**UTILITIES COMMISSION**
**RALEIGH**

DOCKET NO. E-22, SUB 510

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

| | | |
|---|---|---|
| In the Matter of | ) | |
| Fresh Air Energy - II, LLC, and Fresh Air | ) | |
| Energy - X, LLC, | ) | STATEMENT OF POSITION OF |
| Complainants | ) | DOMINION NORTH CAROLINA |
| v. | ) | POWER |
| Virginia Electric and Power Company, d/b/a | ) | |
| Dominion North Carolina Power, | ) | |
| Respondent | ) | |

NOW COMES respondent Virginia Electric and Power Company, d/b/a Dominion North Carolina Power ("DNCP" or the "Company"), by counsel, pursuant to the Order Scheduling Arbitration Hearing issued by the North Carolina Utilities Commission ("Commission") in this proceeding on August 5, 2014 ("Scheduling Order"), and submits its Statement of Position in the above captioned docket.

## I. INTRODUCTION

### A. <u>The Requirement to Implement PURPA</u>

The Public Utility Regulatory Policies Act of 1978 ("PURPA") required the Federal Energy Regulatory Commission ("FERC") to prescribe rules necessary to encourage cogeneration and small power production. *See* 16 U.S.C. §§ 824a-3(a)-(b) (2012). PURPA requires state regulatory bodies to implement the FERC rules. *See* 16 U.S.C. § 824a-3(f) (2012).

### B. <u>The Commission's Implementation of PURPA</u>

This Commission chose to implement PURPA and the related FERC rules through biennial proceedings. Initially, the Commission required some North Carolina utilities to offer the standard long-term levelized rates developed in the biennial proceedings to all qualifying facilities ("QF") regardless of size. *See In the Matter of Biennial Determination of Rates for Sale and Purchase of Electricity Between Electric Utilities and Qualifying Facilities*, Order at 11, Docket No. E-100, Sub 41A (Jan. 22, 1985). In Docket No. E-100, Sub 41, the Commission revisited this policy and determined that the availability of long-term levelized rates adopted in the biennial proceedings should be limited to hydroelectric qualifying facilities and to smaller QFs with generating capacity of five megawatts ("MW") or less. *See id.* at 9, 11-12.

Although the size threshold for small QFs has varied somewhat over time, the Commission's policy of limiting the availability of long-term levelized rates to small QFs has been maintained in every biennial proceeding since Docket No. E-100, Sub 41. In its most recent affirmation of this policy, the Commission held that:

> 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 past avoided cost proceedings strike an appropriate balance between these concerns.

*In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities - 2012*, Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 11, Docket No. E-100, Sub 136 (Feb. 21, 2014) *("2012 Biennial Order")*.

Consistent with its prior policy, in the 2012 Biennial Order the Commission concluded that:

> DEC, DEP, and DNCP should each 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. The

> Commission further concludes that DEC, DEP, and DNCP should offer their five-year levelized rate options to all other QFs 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.

*2012 Biennial Order* at 12.

C. The Current Schedule 19

The 2012 Biennial Order directed the Company to offer long-term levelized capacity payments and energy payments calculated pursuant to the peaker methodology to, among other entities, non-hydroelectric, including solar, QFs contracting to sell five MW or less capacity. *See 2012 Biennial Order* at 47-48. The order also directed the Company to offer, as an alternative, avoided cost rates based upon market clearing process derived from the PJM markets, subject to the same size and contract duration limitations. *See id.* at 48.[1]

1. Schedule 19-FP

The Company's currently effective Schedule 19-FP, Power Purchased from Cogeneration and Small Power Production Qualifying Facilities ("Schedule 19-FP"), was approved by the Commission on February 21, 2014 in the *2012 Biennial Order*.

Schedule 19-FP is available to any QF that desires to deliver all of its net electrical output to the Company and that meets the other eligibility requirements of Schedule 19-FP. *See* Schedule 19-FP, Section I. Under Schedule 19-FP, long-term levelized capacity and energy payments are available only to (a) hydroelectric QFs

[1] The Company complies with this latter requirement through its Schedule 19-LMP as approved in the 2012 Biennial Order. Schedule 19-LMP provides an alternative to avoided cost rates calculated by the peaker method by using the actual prices resulting from the PJM hourly day ahead clearing price market. The Schedule 19-LMP rate and methodology are not an issue in this proceeding and, accordingly, will not be discussed herein.

owned or operated by small power producers as defined in G.S. 62-3(27a) contracting to sell five MW or less of capacity, and (b) non-hydroelectric QFs 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. *See* Schedule 19-FP, Section I.A. A QF that meets the foregoing requirements is eligible for a contract with a term of five, ten or 15 years, at the QF's option. *See id.* Long-term levelized capacity and energy payments under Schedule 19-FP are also available to QFs not defined under Section I.A of Schedule 19-FP that contract to sell three MW or less of capacity. The maximum contract term for these QFs is five years. *See* Schedule 19-FP, Section I.B.

2. <u>Schedule 19-FP Is Not Available To QFs Above Five MWs</u>

As noted above, the 2012 Biennial Order explicitly limited the availability of long-term levelized rate options to relatively small QFs with capacities of five MW or less. For larger QFs, the Company is required to offer the option of (a) participation in the Company's competitive bidding process if it has a Commission recognized active solicitation underway, (b) a contract for purchases of power at a rate derived by free and open negotiations, or (c) a contract for purchases of power at the variable energy rate established by the Commission in the biennial proceedings. *See 2012 Biennial Order* at 13-14.

QFs that are not eligible for Schedule 19-FP are nonetheless entitled to a contract reflecting DNCP's avoided costs, *see 2012 Biennial Order* at 14, and DNCP has an obligation, which it has fulfilled, to "negotiate in good faith with the [QFs] for such terms as are fair to the [QF] as well to the utility's ratepayers." *In the Matter of Biennial Determination of Avoided Cost Rates for Sale and Purchase of Electricity Between*

*Electric Utilities and Qualifying Facilities – 1986/1987*, Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 13, Docket No. E-100, Sub 53 (Apr. 7, 1987).

D. Negotiations with Fresh Air Energy and Petition for Arbitration

It is against the foregoing background that the Company received and responded to the request of Fresh Air Energy - II, LLC ("FAE II") and Fresh Air Energy - X, LLC ("FAE X")[2] for power purchase agreements ("PPAs") with DNCP for the FAE QFs.

FAE II is developing a 20 MW (AC) solar photovoltaic generating facility that will be located at 16825 Watson Seed Farm Road, North Whitakers, Nash County, North Carolina ("Watson Seed Farm Facility") and a 20 MW (AC) solar photovoltaic generating facility that will be located at 1245 Meadows Road, Williamston, Martin County, North Carolina ("Meadows Facility"). FAE X is developing a 20 MW (AC) solar photovoltaic generating facility that will be located in Currituck County, adjacent to Shawboro Road in Moyock, North Carolina ("Shawboro Facility").[3] Each of these Facilities has self-certified with FERC as a QF. *See* Petition for Arbitration at 2-4.

FAE wishes to enter into a separate PPA with the Company for all of the energy and capacity of each Facility at the Company's avoided costs pursuant to PURPA. As noted in the Petition for Arbitration, FAE and the Company have been engaged in good faith negotiations for a PPA for each Facility since on or about December 4, 2013. The Company will continue to engage in free, open and good faith negotiations with FAE for

[2] FAE II and FAE X are referred to collectively as "FAE" for purposes of this pleading.
[3] The Watson Seed Farm Facility, the Meadows Facility and the Shawboro Facility are hereafter referred to collectively as the "Facilities" and individually as a Facility.

a PPA at DNCP's avoided costs for each Facility that is consistent with the requirements of PURPA and this Commission's orders and policies implementing PURPA.

The issues in controversy identified in the Petition for Arbitration concern the avoided cost energy and capacity rates under each PPA and one provision that is common to each PPA. Specifically, the issues are: (1) whether FAE is entitled to a PPA with pricing reflecting the same avoided costs and rate options contained in the Company's currently effective Schedule 19-FP; (2) whether the cost of land should be included in the calculation of avoided capacity costs under PPAs between FAE and the Company; (3) what price the Company is required to pay FAE for capacity during periods when the Company has no need for incremental capacity; (4) whether the Company's avoided energy cost rates "take into consideration the value of the typical diurnal profile of solar output;" (5) whether the Company's avoided cost calculation should include purported fuel hedging benefits from solar generation; and (6) whether the Company can include a "Regulatory Disallowance Provision" in the PPAs. *See* Petition for Arbitration at 6-10.

By order dated July 10, 2014, the Commission directed DNCP to "either satisfy the demands of [FAE], and so advise the Commission, or file a response to the Petition for Arbitration on or before July 30, 2014." Order Requiring Response at 2, Docket No. E-22, Sub 510 (July 10, 2014). DNCP filed a response to the Petition pursuant to this order on July 30, 2014. In its August 5 Scheduling Order, the Commission directed each of FAE and DNCP to exchange information in a cooperative manner in order to understand each other's position and obtain information to develop each one's own position and to present that position to the Commission, and to file with the Commission a verified statement and any necessary exhibits setting forth its position as to the appropriate avoided cost rates and related terms for PPAs for the capacity and energy produced at FAE's facilities. Pursuant to the Scheduling Order, DNCP hereby files its Statement of Position.



## II. STATEMENT OF POSITION

### A. FAE Is Ineligible for the Schedule 19-FP Rates and Options, Which Were Developed for and Expressly Limited to QFs of Five MW or Less.

Because each of the FAE Facilities is larger than five MW, FAE is not entitled either to a Schedule 19-FP contract for any of the Facilities or to the avoided cost rates or options contained in Schedule 19-FP. *See 2012 Biennial Order* at 47 (requiring DNCP to offer standard rates to non-hydroelectric QFs contracting to sell five MW or less capacity); *see also, e.g., In the Matter of Economic Power & Steam Generation, LLC v. Virginia Electric and Power Company*, Order on Arbitration at 2, Docket No. SP-467, Sub 1 (June 18, 2010) ("EP&S is not eligible for the standard rate options because of the size of its proposed QF") ("*EP&S*"); *In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities – 2004*, Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 44, Docket No. E-100, Sub 100 (September 29, 2005) ("The Commission agrees that the standard rates are meant to be available only to small capacity QFs as opposed to larger ones wishing to take advantage of standard rates for a portion of their overall generation.").

For QFs such as the FAE QFs that are not eligible for Schedule 19-FP ("Large QFs"), as noted above, the *2012 Biennial Order* provides that:

> [DNCP] 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, (b) negotiating a contract and rates with the utility, or (c)

> selling energy at the utility's Commission-established variable energy rate.

*2012 Biennial Order* at 48. FAE has not expressed interest in as-available rates, and as stated above the Company does not currently have a Commission-recognized active solicitation for obtaining capacity.

B. <u>DNCP Properly Calculated Avoided Costs for the FAE Facilities Based Upon the LEO Date of the Facilities</u>

1. <u>Each FAE Facility is Entitled to Avoided Costs Calculated at the Time it Established a Legally Enforceable Obligation</u>

Although not eligible for Schedule 19-FP, under PURPA and this Commission's precedent FAE is entitled to a PPA with avoided cost rates that are calculated as of the date of its legally enforceable obligation ("LEO"). An LEO is the right given to a QF to:

> provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:
>
> (i) The avoided costs calculated at the time of delivery;[4] or
> (ii) The avoided costs **calculated at the time the obligation is incurred.**

18 C.F.R. § 292.304(d) (2014) (emphasis added).

Under this Commission's precedent, an LEO for a new QF[5] arises when (1) the QF commits itself to sell its output to a utility pursuant to PURPA, <u>and</u> (2) the QF has

---

[4] DNCP acknowledges that QFs can choose, pursuant to subsection (i) of this rule, to have avoided costs calculated at the time of delivery. However, as FAE has not indicated any interest in this option, the Company will focus its discussion of LEO regulations and precedent on subsection (ii), the option to have avoided costs calculated at the time the obligation is incurred.

[5] Different rules may apply when an already constructed QF with a prior expired contract with a utility is involved. *See In the Matter of EPCOR USA North Carolina LLC v. Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc.*, Order on Arbitration at 8-10, Docket No. E-2, Sub 966 (Jan. 26, 2011).

received a CPCN for the construction of the facility. *See* 2012 Biennial Order at 35; *EP&S* at 8-9; *see also In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities – 1994*, Order on Pending Motions at 3, Docket No. E-100, Sub 74 (February 13, 1995) ("The Commission believes that a QF should contract at the rates in effect at the time when it is in a position to enter into a legally enforceable obligation and that that requires a certificate.") (footnote omitted). Once an LEO is established, under FERC's regulations and the Commission's precedent a QF is entitled to sell its output to the utility at fixed rates based on avoided costs calculated at the time of the LEO and using data available as of the time the LEO is incurred. *See EPS* at 7; 18 C.F.R. § 292.304(d)(ii).

The Commission issued FAE II a CPCN for the Shawboro Facility on December 4, 2013,[6] and issued CPCNs to FAE II for the Watson Seed Farm Facility and the Meadows Facility on February 26, 2014 and March 20, 2014, respectively. Applying the Commission's precedent discussed above, and assuming that FAE's contacting DNCP on December 4, 2013 to initiate the negotiation process constituted a commitment by FAE to sell the output of the Facilities to DNCP, the LEO for the Shawboro Facility was established on December 4, 2013. The LEOs for the Watson Seed Farm Facility and the Meadows Facility were established on February 26, 2014, and March 20, 2014, respectively, which are the dates on which the output of each Facility had been offered to DNCP <u>and</u> the Facility had received a CPCN.

[6] The Shawboro Facility CPCN was transferred by Commission order to FAE X on April 30, 2014. *See* Petition for Arbitration at 3-4.

On January 17, 2014, DNCP provided FAE with avoided cost pricing using data available as of December 4, 2013, which was the LEO date for the Shawboro Facility. The most important component of the data used to calculate avoided costs for FAE was the Company's 2013 Integrated Resource Plan ("IRP"). Because there were no changes to the Company's long-term cost projections between the date of the Shawboro Facility LEO (December 4, 2013) and the March 20, 2014 LEO for the Meadows Facility, the avoided cost prices provided to FAE in January 2014 are also applicable to the Meadows Facility and the Watson Seed Farm Facility.

The avoided cost rates provided by DNCP for each FAE Facility are consistent with DNCP's obligation under PURPA to purchase the Facility's output at avoided costs "calculated at the time the obligation is incurred," 18 C.F.R. § 292.304(d), using data available as of the time each FAE Facility's LEO was established.[7] It is true, as FAE points out in its Petition for Arbitration, that the rates in the FAE PPAs are lower than the Schedule 19-FP rates approved by the Commission in the 2012 Biennial Order. That fact, however, is not relevant, as Schedule 19-FP rates are not applicable to FAE. PURPA guarantees QFs rates based on avoided costs calculated at the time an LEO is established, and that is what DNCP has provided to FAE.

2. <u>Requiring DNCP to Make Payments to FAE based on Avoided Costs Approved in the 2012 Biennial Order Would Violate PURPA</u>

In its Petition for Arbitration, FAE also asserts that it is entitled to a PPA containing rates "reflect[ing] the same avoided costs underlying" the standard rates established by the Commission in the 2012 Biennial Order (the "2012 Standard Rates")

[7] The avoided cost pricing provided to FAE is set forth in Confidential Exhibit 1 hereto.

because the Facilities' LEO arose during the "2012 biennium" (i.e., the period beginning November 1, 2012 through November 1, 2014). *See* Petition for Arbitration at 6-7. Requiring the Company to enter into a PPA using the avoided cost data on which Schedule 19-FP is based would clearly violate 18 C.F.R. § 292.304.

The Company's proposed Schedule 19-FP was submitted to the Commission on November 1, 2012, and corrected on November 5, 2012, *see 2012 Biennial Order* at 4. The avoided costs incorporated in that Schedule 19-FP, and the 2012 Standard Rates, were calculated based on data available at that time, which was the data contained in and assumptions consistent with the Company's August 2012 IRP. The fact that the LEO dates of each FAE Facility were established during the "biennium period" covered by the Commission's 2012 Biennial Order is not relevant because Schedule 19-FP rates are not applicable to the FAE Facilities, which are instead governed by 18 C.F.R. § 292.304(d).

As noted above, Section 292.304(d) of FERC's regulations entitles a QF to avoided costs **calculated at the time the obligation is incurred**. *See* 18 C.F.R. § 292.304(d) (emphasis added). FAE had not established an LEO for any of its facilities as of November 1, 2012, when DNCP filed for approval of its standard rates, and under PURPA and this Commission's precedent is entitled only to avoided cost rates calculated as of the date of its LEO, using data available as of the date of its LEO. By the time FAE had established LEOs for its Facilities, in December 2013, February 2014 and March 2014 respectively, the data supporting the 2012 Standard Rates no longer reflected the Company's avoided costs. By this time, new data, most importantly the Company's 2013 IRP, had supplanted the data, and some of the assumptions, underlying the 2012 Standard

Rates and, under 18 C.F.R. § 292.304(d), avoided cost payments to FAE were required to be calculated using this new data.

In addition to violating 18 C.F.R. § 292.304(d), calculating avoided cost payments to FAE using the avoided cost data underlying the 2012 Standard Rates would also violate the requirement of 18 C.F.R. § 292.304(a) that rates for purchases from QFs be just and reasonable to the electric utility consumer and in the public interest, and the prohibition on requiring a utility to pay more than its avoided costs for QF output, *see* 18 C.F.R. § 292.304(a)(1)-(2) (2014). Payments to FAE based on the avoided cost data underlying the 2012 Standard Rates would result in DNCP paying well in excess of its avoided costs calculated using data available as of the dates of the FAE LEOs.

C. <u>The Methodology Used by DNCP to Calculate Avoided Costs is Consistent with PURPA</u>

The peaker method that the Company used to calculate avoided costs for the FAE PPAs is similar to that used to calculate avoided costs for the 2012 Standard Rates. However, since the 2012 Biennial Order, DNCP had refined its methodology and assumptions to more accurately reflect its avoided costs consistent with PURPA not only to be more accurate, but also to address the increased risk to ratepayers associated with Large QFs. This increased risk from Large QFs is amplified by the expected large volume and high penetration of intermittent QFs in DNCP's service territory that became apparent in 2013. Based on current information, planned QF developments (over 50% of which are QFs larger than five MW) now exceed 150% of DNCP's total average load in North Carolina.

The two principal differences between the peaker method used to develop avoided costs for Schedule 19-FP and the method used to develop avoided costs for FAE are: (1)

the use of the net versus gross peaker method to calculate avoided capacity costs (the "Net Peaker Methodology"), and (2) the adjustment in the early year capacity values to better reflect the Company's actual avoided capacity costs.

1. Net Peaker Methodology. Historically, the combustion turbine ("CT") energy-related benefit was not an important distinction because CTs ran only limited hours per year. When they did run, CTs were the units on the margin (highest cost). In other words, a CT's cost closely matched a "pure capacity" value. Today, a new CT can be expected to run significantly more, with an annual capacity factor of 5-10%. This is because CT performance — due to technology improvements and reduced heat rates — has improved, and the cost of gas relative to other fuels has decreased. Increased run time means that a CT can deliver substantial benefits in terms of energy, including ancillaries, for customers, producing energy below the wholesale power market price in many hours. In light of these developments, while the addition of QF power allows the Company to avoid the capital costs of constructing a CT, the Company also forgoes the fuel savings of the avoided CT unit. This lost fuel savings can be material and therefore must be accounted for in the avoided cost rates to accurately determine the Company's avoided capacity costs. Accordingly, under the Net Peaker Methodology, the avoided capacity costs equal the fixed costs of the next CT that DNCP plans to build, net of the expected energy benefits, including ancillary service benefits, from the CT.

The Net Peaker Methodology is consistent with the analysis used by DNCP for generation planning purposes, which recognizes that adding a new CT to the system provides both capacity and energy value, and that to ignore the energy value would understate the benefits and overstate the capacity cost. The Net Peaker Methodology is also used by PJM, New York ISO, and New England ISO to determine the value of capacity in their competitive markets. FERC has accepted the "net energy and ancillary services revenue offset" concept in the development of capacity market prices, where the energy and ancillary service related values from a CT are subtracted from the CT construction cost. *See, e.g., PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 at PP 116, 118 (2006) (approving PJM proposal for calculating Net CONE by "subtracting the net revenues earned from the sale of energy and ancillary services from the cost of new entry for new capacity providers."), *order on reh'g*, 119 FERC ¶ 61,318, *order denying reh'g*, 121 FERC ¶ 61,173 (2007).

2. Adjustment in Early Year Capacity Payment Rates. The avoided capacity payment rates in the early years of the FAE PPAs are less than the capacity payment rates in the later years. This is consistent with the peaker method and with the requirements of PURPA. Put simply, PURPA does not require a utility to pay for capacity that is not, in fact, avoided. In Order No. 69, FERC stated:

> [i]n order to defer or cancel the construction of new generating units, a utility must obtain a commitment from a qualifying facility that provides contractual or other legally enforceable assurances that capacity from alternative sources will be available sufficiently ahead of the date on which the utility would otherwise have to commit itself to the construction or purchase of new capacity. If a qualifying facility provides such assurances, it is entitled to receive rates based on the capacity costs that the utility can avoid as a result of its obtaining capacity from the qualifying facility.

*Small Power Production and Cogeneration Facilities,* Order No. 69, 45 Fed. Reg. 12,214, at 12,225 (Feb. 25, 1980) ("*Order No. 69*").

More generally, FERC has "made clear that an avoided cost rate need not include capacity costs (as distinct from energy costs) where a QF does not 'permit the purchasing utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility … Accordingly, an avoided cost rate need not include capacity unless the QF purchase will permit the purchasing utility to avoid building or buying future capacity … while utilities may have an obligation under PURPA to purchase from a QF, that obligation does not require a utility to pay for capacity that it does not need." *City of Ketchikan*, 94 FERC ¶ 61,293, at 62,061-62,062 (2001); *see also* Order No. 69, 45 Fed. Reg. at 12,226 (affirming position that "if a [QF] offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating plant, to enable it to build a smaller, less expensive plant, or to purchase less firm power from another utility than it would otherwise have purchased, then the rates for purchases from the [QF] must include the avoided capacity and energy costs.").

This Commission has also recognized this fundamental principle in orders holding that the Company was not required to offer capacity credits to QFs during periods when the Company in fact had no capacity needs.[8] In those cases, the Commission recognized that no capacity credit should be offered where no capacity costs were avoided.

Notwithstanding the foregoing, in the context of negotiations and the overall avoided cost package provided to FAE in January 2014, DNCP did offer to pay FAE a

---

[8] *See In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities - 1998,* Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 6, 16, Docket No. E-100, Sub 81 (July 16, 1999); *see also In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities - 1996,* Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 8, 21-22, Docket No. E-100, Sub 79 (June 19, 1997); *In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities - 1994,* Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 8, 27, Docket No. E-100, Sub 74 (June 23, 1995).

capacity rate for the period 2015 – 2016, which was based on PJM incremental auction clearing prices for that period. Unless other components of the overall avoided cost package are modified, the Company stands by this prior commitment to FAE. If other components of the overall avoided cost package are modified, the Company reserves the right to take the position that no capacity payments are required for the first three years after the QFs commence commercial operations, for the reasons discussed above and in its testimony as provided in Docket No. E-100, Sub 140. *See* Direct Testimony of Bruce E. Petrie on Behalf of Dominion North Carolina Power at 10, Docket No. E-100, Sub 140 (Apr. 25, 2014); Rebuttal Testimony of Bruce E. Petrie on Behalf of Dominion North Carolina Power at 3-5, Docket No. E-100, Sub 140 (June 20, 2014).

D. FAE is Not Entitled to the Option B Rates Contained in Schedule 19-FP

The Option B rates contained in Schedule 19-FP are available only to QFs that are eligible for Schedule 19-FP, which FAE is not. As noted by the Commission in the *2012 Biennial Order*, the addition of Option B to the Company's Schedule 19-FP was the result of a stipulation between DNCP and the Public Staff. *See 2012 Biennial Order* at 28. That stipulation, however, was for the limited purposes of the 2012 Biennial Proceeding and was without prejudice to any position that a stipulating party could take with respect to those issues or analogous issues in any other proceeding. *See* Stipulation of Settlement Between Dominion North Carolina Power and the Public Staff at 4, Docket No. E-100, Sub 136 (Oct. 29, 2013).

As discussed in the Company's recent testimony in Docket E-100, Sub 140, the Company believes that a single definition of on-peak hours for capacity and a single definition of on-peak hours for energy, that each appropriately reflects the utility's load demand, is appropriate and should be used to calculate avoided costs for all QFs. Providing multiple options unnecessarily complicates the process for paying QFs for capacity, and potentially provides options that do not align appropriately with avoided cost principles. Allowing QFs to choose between multiple sets of on-peak hours options permits QFs to choose the definition that produces the most revenues for the QF relative to their operations, which in turn ensures that electric utility customers will always pay the higher of the available options offered to the QFs. While this is beneficial to the QF, it leads to an overstatement of the actual avoided costs to the utility.

E. DNCP Properly Excluded the Cost of Land From Its Avoided Cost Calculation Because It Plans to Build the Peaker Units on Which Its Avoided Capacity Cost Estimates are Based on Brownfield Sites

DNCP did not include land costs in the calculation of the avoided capacity costs for the FAE PPAs because, as explained below, the inclusion of such costs is inconsistent with the dictates of PURPA under the Company's current circumstances. FAE noted in its Petition for Arbitration that the Public Staff in Docket No. E-100, Sub 140 stated that land costs should be included in the calculation of avoided capacity cost. *See* Petition for Arbitration at 8. As DNCP explained in its Response filed in this proceeding, the Company respectfully submits that the Public Staff's position on this issue is inconsistent with PURPA.

Avoided costs are defined under FERC's regulations implementing PURPA as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source."[9] Further, avoided cost rates must be "just and reasonable to the electric consumer of the electric utility and in the public interest" and an electric utility is not required to "pay more than the avoided costs for purchases."[10] The Company's avoided capacity cost estimates used in the FAE PPAs are consistent with the Company's most recent IRP (i.e., the 2013 IRP) in effect at the time of the FAE LEOs. As reflected in the 2013 IRP, the Company's next peaker CT will be developed at an existing brownfield site already owned by the Company. Because the CT will be constructed at a brownfield site, the Company will not incur or avoid any land costs associated with the CT, and therefore the avoided land costs are $0. Requiring the Company's ratepayers to bear costs that are not in fact avoided is not just and reasonable, and requiring the Company to pay capacity rates that include an allowance for land costs that are not avoided will result in the Company paying more than its avoided costs for capacity in violation of PURPA.

In the Docket No. E-100, Sub 87 order referenced by FAE, the Commission did not hold that land costs should be included in avoided capacity cost estimates even if such costs are not avoided. In that proceeding, DNCP used the projected capital cost of the Ladysmith CT units 1-2 for its avoided capacity calculations. The Public Staff pointed out that the Company's estimates did not include the cost of land, and the Company agreed to add the cost of land because the Ladysmith site was a greenfield site (i.e., the Company would have to purchase land for the generating units). However, as the Commission noted in its order in that proceeding, the Company did not agree that

[9] 18 C.F.R. § 292.101(b)(6) (2014).
[10] 18 C.F.R. § 292.304(a) (2014).

inclusion of land costs was always appropriate:

> NC Power . . . agreed land costs should be included in the calculations in cases where land costs could actually be avoided. However, the [C]ompany pointed out that new capacity is sometimes added at existing sites where land costs cannot be avoided.[11]

Because the Company had agreed to the Public Staff's request to include land costs in that proceeding, the Commission adopted "NC Power's agreement to include land costs in its capacity credits, and conclude[d] that NC Power should be required to include the capital costs of land in its calculation of capacity credits for purposes of this proceeding." *Id.* at 12-13 (emphasis added). The Commission did not hold, and the Company did not concede in that case, that land costs should be included in avoided cost estimates based on installation of new capacity at a brownfield site; requiring the inclusion of non-existent land costs would, as discussed above, be inconsistent with the plain requirements of PURPA.

F. DNCP's Methodology for Calculating Avoided Energy Cost Rates Appropriately Accounts for Energy Costs Avoided by the Company Through the Purchase of Energy from Solar QFs and is Consistent With the Requirements of PURPA and this Commission's Orders Implementing PURPA

FAE's claim that the Company's "avoided energy costs do not take into consideration the value of the typical diurnal profile of solar output," Petition for Arbitration at 9, is not correct. The Company calculates avoided energy cost rates with a production cost model that adds a zero-cost 150-MW flat block of energy to the DNCP system; the avoided energy cost is then calculated as the change in system production

[11] *In the Matter of Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from Qualifying Facilities – 2000*, Order Establishing Standard Rates and Contract Terms for Qualifying Facilities at 12, Docket No. E-100, Sub 87 (Apr. 6, 2001).

cost divided by the MWh from the zero-cost block of QF energy. This method quantifies the value of energy during the on-peak hours and the off-peak hours by producing energy rates based on DNCP's system marginal cost of energy. By representing the average value of energy for deliveries during the relevant hours, these energy rates also constitute a price signal to the QF—to the extent the QF, including a solar QF, can produce more energy during the on-peak hours, it will collect more energy revenues. A solar QF's increased production during on-peak hours and resulting revenues under this approach effectively compensate that QF according to its profile.

G. There Are No Fuel Hedging Benefits Associated With the FAE Facilities That Should Be Reflected in Avoided Cost Rates

Purchases of power from solar QFs do not allow the Company to avoid any hedging costs. DNCP does not benefit from having fixed prices at the expected marginal energy price (as does a QF contract). If demand or fuel prices are lower than forecasted, then the fixed prices are likely to be adverse to customers. If natural gas prices (assuming natural gas is the marginal fuel) are substantially higher than forecasted, then the Company can utilize the fuel diversity and optionality of its fleet to dispatch other fuel type units, or purchase energy from the PJM market. Locking in energy prices at the marginal price, without any option on whether to dispatch the unit (or purchase the energy), is actually more likely to be adverse to the Company and its customers, rather than beneficial.

In addition, the cost per unit of generation of hedging natural gas is minimal. When entering into a near-term forward hedge for natural gas, where there is a large liquid market, there are relatively minimal transaction costs.

Finally, DNCP currently has a limited natural gas hedging program. DNCP's current hedging policy is to target hedging up to 25% of the low load case expected gas usage during the summer and winter months. Hedges are placed over a period of time from 1 to 12 months in advance of the month during which the gas is expected to be used. For example, for calendar year 2015, DNCP has hedges for only approximately 2.0% of its expected natural gas usage.

Due to all of these considerations, DNCP's purchase of solar QF output does not permit the Company to avoid any hedging costs, and hedging costs are therefore not properly included in avoided energy cost calculations.

### H. The Company Is Entitled and Has Been Expressly Authorized by the Commission to Include a "Regulatory Disallowance Provision" in Non-Schedule 19 PPAs

On February 24, 2014, DNCP provided FAE a draft PPA for the Shawboro Facility.[12] The draft PPA provided to FAE for the Shawboro Facility will also form the basis for the PPAs for the other FAE Facilities.

FAE objects to the inclusion of the Regulatory Disallowance Provision in the draft PPA, asserting that the provision (1) creates significant financial exposure to the QF, (2) deprives a potential investor with the ability to estimate its expected return and investment with reasonable certainty, and (3) based on FAE's parent's experience in other states, is preventing the company from securing financing. *See* Petition for Arbitration at 9-10. The Commission recently, directly, and correctly held that it was reasonable for the Company to include a Regulatory Disallowance Provision in non-Schedule 19 PPAs. Specifically, the Commission held that:

[12] The draft PPA provided to FAE is set forth in Confidential Exhibit 2 hereto.

DNCP has demonstrated that the risk of a Disallowance Order is a remote risk, the probability of which can be evaluated by QF developers with reasonable certainty. **The Commission agrees with DNCP that, because DNCP is legally obligated by PURPA to purchase the output of QFs, if a Disallowance Order is issued and found to be lawful, it would be inequitable for the burden of a Disallowance Order to be borne by the Company and its shareholders.** However, the Commission also finds that the evidence demonstrates that Article 6, as previously approved by the Commission, has presented a barrier to financing for some QFs that may be unnecessary.

The Commission orders that DNCP shall no longer include the Regulatory Disallowance Clause in contracts entered into with QFs that are subject to rates already approved by the Commission. In these circumstances, as the Commission has already approved the contracted rates, the probability of a Disallowance Order is relatively non-existent, and, thus, the inclusion of the Regulatory Disallowance Clause provides no benefit but has been shown to unnecessarily hinder potential QF financing. **The Commission further orders that it is not unreasonable for DNCP to include the Regulatory Disallowance Clause in contracts with QFs that include negotiated rates, subject to the following amendments:** (1) DNCP shall include language stating that nothing in the clause should be construed by either party as giving DNCP the right to modify the rates in a PPA in the absence of cost disallowance by a governmental regulatory agency with jurisdiction and that DNCP will exercise its reasonable best efforts to avoid and challenge a Disallowance Order; and (2) the clause shall include language noting the limited circumstances in which Disallowance Orders have been issued, in particular, providing the percentage of contracts, out of all PPAs entered into between DNCP and QFs, for which Disallowance Orders have been issued over the last 10 and 20-year periods. The Commission believes these amendments will enable potential financiers to better understand and analyze the risk of financing projects subject to [the Regulatory Disallowance Provision]. Finally, the Commission encourages QFs and DNCP to work together, including having DNCP discuss the Regulatory Disallowance Clause with potential financiers, so that all parties have a firm understanding of the implications and limitations of such a clause.

*2012 Biennial Order* at 45-46 (emphasis added).

Due to the close proximity of the issuance of the *2012 Biennial Order* and the delivery of the draft PPA to FAE on February 24, 2014, the draft PPA did not contain the language or information required by clauses (1) and (2) above.[13] The Company confirms

[13] The percentage of contracts for which a Disallowance Order has been issued over the last 10 and 20-year periods is 0%. Prior to that time, both this Commission and the Virginia State Corporation Commission

that such clauses, which were designed to alleviate the types of concerns expressed by FAE, will be included in the final PPAs with FAE.

Regardless of FAE's parent company's experience in "[other] states," this Commission has determined that the Regulatory Disallowance Provision is reasonable because "if a Disallowance Order is issued and found to be lawful, it would be inequitable for the burden of a Disallowance Order to be borne by the Company and its shareholders." *2012 Biennial Order* at 45. FAE has not indicated whether the potential lenders it has approached have done any due diligence on the Regulatory Disallowance Provision or whether FAE has informed potential lenders about the *2012 Biennial Order*'s determinations with respect to the provision. The Company notes that it has offered to work with FAE to help its potential lenders understand the Regulatory Disallowance Provision, which offer remains open.

**WHEREFORE,** Dominion North Carolina Power submits this Statement of Position for the Commission's consideration in the above-captioned proceeding and respectfully requests that the Commission issue an order finding that:

1. the LEO for the Shawboro Facility is December 4, 2014, the LEO for the Watson Seed Farm Facility is February 26, 2014, and the LEO for the Meadows Facility is March 20, 2014;

---

(VSCC) disallowed recovery of avoided cost payments to non-standard rate QFs. In 1993, this Commission disallowed North Carolina rate recovery of a portion of the Company's avoided cost payments to two Virginia QFs because it concluded that the avoided cost payments ordered by the VSCC exceeded DNCP's avoided costs. *See Ex rel. Utilities Commission v. North Carolina Power*, 338 N.C. 412; 450 S.E.2d 896 (NC 1994); *cert. denied* 516 U.S. 1092 (1996). Similarly, the VSCC disallowed recovery of a portion of payments to QFs when it subsequently determined that the avoided costs under the QF contracts erroneously included costs that were not in fact avoided costs. *Hopewell Cogeneration Ltd. Partnership v. State Corporation Commission*, 249 Va. 107, 453 S.E.2d 277 (Va. 1995); *cert. denied,* 516 U.S. 817 (1995).

2. FAE is not entitled to a PPA containing rates based on avoided cost information underlying the Schedule 19-FP rates approved in the 2012 Biennial Order;

3. each FAE QF is entitled to avoided cost rates calculated at the time of its LEO and using data available as of the time the LEO is incurred;

4. the avoided cost methodology utilized by DNCP in calculating avoided costs for the FAE PPAs is consistent with PURPA and Commission precedent;

5. DNCP is not required to include the cost of land in avoided capacity cost determinations when no such costs will be avoided by the Company;

6. PURPA does not require the Company to pay FAE for capacity that will not in fact be avoided;

7. the Company is not required to offer FAE the Option B that is available to QFs eligible for Schedule 19-FP;

8. the Company's avoided energy cost calculations appropriately account for energy costs avoided by purchases from solar QFs;

9. there are no fuel hedging benefits associated with the FAE Facilities that are cognizable avoided costs;

10. the Company is entitled and has been expressly authorized by the Commission to include a "Regulatory Disallowance Provision" in non-Schedule 19 PPAs such as the FAE PPAs; and

11. order such other and further relief as the Commission deems just, equitable and proper.

Respectfully submitted,

DOMINION NORTH CAROLINA POWER

By: _*/s/ Andrea R. Kells*_________________

Andrea R. Kells
McGuireWoods LLP
434 Fayetteville Street, Suite 2600
Raleigh, NC 27601
Phone: (919) 755-6614
Fax: (919) 755-6699
akells@mcguirewoods.com

Horace P. Payne, Jr.
Senior Counsel
Dominion Resources Services, Inc.
Law Department
120 Tredegar Street
Richmond, VA 23219
Phone: (804) 819-2692
Fax: (804) 819-2183
horace.p.payne@dom.com

*Attorneys for Virginia Electric and Power Company*

Dated: September 3, 2014

# VERIFICATION

I, Roger Williams, being duly sworn, deposes and says: that I have read the foregoing Statement of Position of Dominion North Carolina Power and the same is true of my personal knowledge, except as to any matters and things therein stated upon information and belief, and as to those, I believe them to be true, and that I am authorized to sign this verification on behalf of Virginia Electric and Power Company, d/b/a Dominion North Carolina Power.

This 3rd day of September, 2014

COMMONWEALTH OF VIRGINIA )
) to wit
City of Richmond )

The foregoing instrument was sworn to and acknowledged before me this 3rd of September 2014.

Notary Public # 270003

My commission expires July 31, 2016.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Statement of Position of Dominion North Carolina Power* as submitted in Docket No. E-22, Sub 510 has been served electronically or via U.S. mail, first-class, postage prepaid, upon all parties of record.

Fresh Air Energy II, LLC and Fresh Air Energy X, LLC

Charlotte Mitchell
Law Office of Charlotte Mitchell
P.O. Box 26212
Raleigh, North Carolina 27604
www.lawofficecm.com

Public Staff – North Carolina Utilities Commission

Christopher J. Ayers
Executive Director
4326 Mail Service Center
Raleigh, North Carolina 27699-4326
Chris.Ayers@psncuc.nc.gov

This, the 3rd day of September, 2014.

*s/Andrea R. Kells*
McGuireWoods LLP
434 Fayetteville Street, Suite 2600
PO Box 27507 (27611)
Raleigh, North Carolina 27601
(919) 755-6614 Direct
akells@mcguirewoods.com

*Attorney for Virginia Electric and Power Company d/b/a Dominion North Carolina Power*