

149 FERC ¶ 61,220  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Chairman;  
Philip D. Moeller, Tony Clark,  
and Norman C. Bay.

Duke Energy Progress, Inc.

Docket Nos. ER15-74-000  
EC15-9-000

ORDER AUTHORIZING ACQUISITION OF JURISDICTIONAL FACILITIES AND  
ACCEPTING POWER PURCHASE AGREEMENTS

(Issued December 9, 2014)

1. On October 10, 2014, pursuant to section 203(a)(1)(D) of the Federal Power Act (FPA),<sup>1</sup> Duke Energy Progress (Duke Progress) filed an application (203 Application) requesting authorization to acquire the interests of North Carolina Eastern Municipal Power Agency (Power Agency) in certain generating units that Duke Progress jointly owns with Power Agency (Proposed Transaction). Also on October 10, 2014, Duke Progress filed, pursuant to section 205 of the FPA,<sup>2</sup> a new cost-based full requirements power purchase agreement (Full Requirements Agreement) between itself and Power Agency and proposed amendments to five wholesale cost-based power sales agreements pursuant to which Duke Progress' demand charges are calculated pursuant to a cost-of-service formula rate (Amended Agreements).<sup>3</sup> In particular, Duke Progress requests

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<sup>1</sup> 16 U.S.C. § 824b(a)(1)(D) (2012).

<sup>2</sup> 16 U.S.C. § 824d (2012).

<sup>3</sup> The five Amended Agreements are between Duke Progress and the following wholesale customers: Public Works Commission of the City of Fayetteville, North Carolina (Fayetteville); French Broad Electric Membership Cooperative; North Carolina Electric Membership Corporation; The City of Camden, South Carolina; and Piedmont Electric Membership Corporation. Duke Progress October 10, 2014 Transmittal Letter at n.3 (205 Filing).

authorization to include an acquisition adjustment of approximately \$343 million resulting from the Proposed Transaction in wholesale rates under the Full Requirements Agreement and Amended Agreements.

2. We have reviewed the Proposed Transaction pursuant to the Commission's Merger Policy Statement.<sup>4</sup> As discussed below, we authorize the Proposed Transaction as consistent with the public interest. Additionally, for the reasons discussed below, we accept the Full Requirements Agreement and the Amended Agreements, and we authorize Duke Progress to reflect the acquisition adjustment in the rates charged under these agreements.

## **I. Background**

### **A. Description of the Parties**

#### **1. Duke Progress**

3. Duke Progress, a wholly-owned subsidiary of Duke Energy Corporation, is a vertically-integrated electric utility organized in North Carolina and headquartered in Raleigh. It provides electricity and related services to nearly 1.5 million customers in North and South Carolina and serves a territory encompassing more than 34,000 square miles. Duke Progress' retail service is subject to the jurisdiction of the North Carolina Utilities Commission (North Carolina Commission) and the Public Service Commission of South Carolina (South Carolina Commission). Duke Progress owns and operates approximately 12,221 megawatts (MW) of generating resources.<sup>5</sup>

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<sup>4</sup> See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). See also *FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253 (2007), *order on clarification and reconsideration*, 122 FERC ¶ 61,157 (2008). See also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001). See also *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

<sup>5</sup> 203 Application at 3.

## 2. Power Agency

4. Power Agency is a municipal joint action agency created pursuant to Chapter 159B of the North Carolina General Statutes<sup>6</sup> that serves as the all-requirements bulk power supplier to 32 cities and towns in eastern North Carolina (Participants) that formerly were wholesale electric service customers of Carolina Power & Light Company (the predecessor of Duke Progress) or Virginia Electric and Power Company. Power Agency and its Participants are part of Duke Progress' eastern balancing authority area (BAA). Power Agency currently serves its Participants' needs with capacity and energy from its share of five generating units that it jointly owns with Duke Progress (the Joint Units), which Duke Progress operates, and with supplemental capacity, energy, and backup power that it purchases from Duke Progress.<sup>7</sup>

### B. The Joint Units

5. Duke Progress states that the Joint Units consist of Power Agency's interests in: (1) the Brunswick steam electric plant, Unit 1 (Brunswick 1), a nuclear unit located in Southport, North Carolina with a Nuclear Regulatory Commission (NRC) license that expires in 2036 and a capacity of approximately 938 MW; (2) the Brunswick Steam Electric Plant, Unit 2 (Brunswick 2), a nuclear unit also located in Southport, North Carolina with an NRC license that expires in 2034 and a capacity of approximately 932 MW; (3) the Shearon Harris Nuclear Power Plant, Unit 1 (Harris Unit), a nuclear unit located in New Hill, North Carolina with an NRC license that expires in 2046 and a capacity of approximately 928 MW; (4) the Mayo Station (Mayo Plant), a coal-fired unit located in Roxboro, North Carolina with a capacity of approximately 727 MW; and (5) the Roxboro Station, Unit 4 (Roxboro Unit), a coal-fired unit located in Semora, North Carolina with a capacity of approximately 698 MW.<sup>8</sup> Power Agency's ownership interests in these facilities represent approximately 701 MW of generating capacity (approximately 493 MW of nuclear capacity and 208 MW of coal-fired capacity), as follows: (1) 18.33 percent or 171.9 MW in Brunswick 1; (2) 18.33 percent or 170.8 MW in Brunswick 2; (3) 16.17 percent or 150.1 MW in the Harris Unit; (4) 16.17 percent or 117.6 MW in the Mayo Plant; and (5) 12.94 percent or 90.3 MW in the Roxboro Unit.<sup>9</sup>

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<sup>6</sup> N.C. Gen. Stat. Chapter 159B.

<sup>7</sup> 203 Application at 4.

<sup>8</sup> 205 Filing at 16-17.

<sup>9</sup> *Id.*

6. Duke Progress states that Power Agency acquired its interests in these facilities in the early 1980s as part of an effort to achieve “a reliable and balanced long-term power supply for its members at a reasonable cost.”<sup>10</sup> Duke Progress asserts that, to finance its acquisition of the Joint Units, Power Agency issued revenue bonds totaling \$1.3 billion at a time of “extraordinarily high” interest rates and that this debt has increased due to a variety of factors. Duke Progress represents that, as of the end of 2013, Power Agency’s debt had grown to over \$2 billion with annual debt service costs exceeding \$260 million in 2013, an amount that represents more than one-third of Power Agency’s overall expenses.<sup>11</sup> According to Duke Progress, these debt obligations have resulted in high rates for Power Agency’s members and retail customers.

### **C. The Proposed Transaction**

7. Duke Progress states that it has entered into an asset purchase agreement with Power Agency pursuant to which Power Agency will sell and Duke Progress will purchase the Joint Units for a purchase price of \$1.2 billion, subject to certain adjustments for capital expenditures incurred by Power Agency after January 1, 2015 and prior to closing. Duke Progress also states that, assuming the Proposed Transaction closes at the end of 2015, the purchase price, which is capped at \$1.278 billion, would reflect an acquisition adjustment of approximately \$343 million.<sup>12</sup> Duke Progress asserts that the agreement resulted from an arms-length negotiation in which Power Agency sought a price that would enable it to retire a substantial amount of its outstanding debt. Duke Progress states that it sought to acquire these interests at a price that would enable its retail and wholesale customers to obtain lower overall rates over the lives of the Joint Units.<sup>13</sup>

8. Duke Progress states that, as part of the Proposed Transaction, in addition to acquiring the Joint Units, Duke Progress will acquire Power Agency’s interests in: (i) all related real property; (ii) the nuclear decommissioning trust funds associated with Power Agency’s ownership share of the nuclear Joint Units, and all proceeds and rights therein, and a related internal fund for nuclear decommissioning;<sup>14</sup> (iii) nuclear fuel

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<sup>10</sup> *Id.* at 3.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 5.

<sup>13</sup> 203 Application at 6.

<sup>14</sup> *Id.* at 7. Duke Progress states that Power Agency has accrued approximately \$26 million internally to supplement the externally-held funds. *Id.* n.3. Duke Progress

inventory purchased for the Harris, Brunswick 1, and Brunswick 2 units; (iv) spare parts inventory of the Joint Units and any related support facilities, including equipment, tools, goods, and supplies; and (v) plant permits.<sup>15</sup> Duke Progress asserts that it will also assume certain liabilities as set out in the asset purchase agreement.

#### **D. Full Requirements Agreement**

9. Duke Progress states that it has had a long-standing power supply relationship with Power Agency, as a partial or full requirements supplier for Power Agency and its Participants. It further states that Power Agency's Participants currently obtain about 75 percent of their annual energy needs from the Joint Units. To this end, Duke Progress states that the existing Restated and Amended Capacity Power Coordination Agreement (Power Coordination Agreement) between itself and Power Agency provides that the Joint Units are available to and may be used by Duke Progress to service the loads of Power Agency's Participants. Duke Progress also asserts that, pursuant to this agreement, Duke Progress must provide all of the capacity and energy necessary to serve Power Agency's load that exceeds Power Agency's Joint Unit capacity and energy entitlements. Furthermore, Duke Progress and Power Agency are parties to a Supplemental Load Agreement that provides revised terms pursuant to which Duke Progress would supply supplemental capacity and energy to Power Agency from January 1, 2018 through December 31, 2031, a period immediately after the expiration of the Power Coordination Agreement. In Docket No. ER05-74-000, Duke Progress has submitted a Full Requirements Agreement for filing that will supersede the Power Coordination Agreement and the Supplemental Load Agreement if Duke Progress and Power Agency consummate the Proposed Transaction.<sup>16</sup>

10. Pursuant to the Full Requirements Agreement, which goes into effect at the closing of the Proposed Transaction and terminates on December 31, 2043, Duke Progress will provide all of Power Agency's capacity and energy requirements with the same degree of firmness and level of service priority that Duke Progress provides for its other firm native load customers. The agreement also provides for Power Agency and its Participants to own and operate generation that would displace service provided by Duke

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states that the externally and internally-held funds meet the NRC's requirements with respect to nuclear decommissioning. *Id.*

<sup>15</sup> *Id.* at 7.

<sup>16</sup> 205 Filing at 15.

Progress. Duke Progress states that the calculations of charges for capacity, energy, and reserve service under the Full Requirements Agreement are pursuant to formula rates.<sup>17</sup>

11. Duke Progress states that the agreement's capacity rate formula incorporates a return on equity of 11.0 percent, while the decommissioning expense is specified as that most recently adopted by the Commission. Duke Progress further states that the capacity rate formula includes the recovery of and a return on the acquisition adjustment associated with Duke Progress' purchase of the Joint Units and other assets to be acquired. Duke Progress further asserts that the energy rate formula calculates Duke Progress' average energy-related production cost.<sup>18</sup>

12. Duke Progress also states that, with certain narrow exceptions, each party's right to propose changes to the Full Requirements Agreement pursuant to section 205 or section 206 of the FPA will be governed by the "just and reasonable" standard of review and that the same standard of review applies to changes proposed by a third party or the Commission on its own motion. The exceptions, which are governed by the "public interest" standard of review, apply to: (1) a compensation provision relating to Power Agency's right to reduce purchases should Duke Progress add nuclear capacity to its fleet; (2) the inclusion in Duke Progress' rate base of the unamortized balance of the acquisition adjustment that Duke Progress will pay as part of the Proposed Transaction (as discussed below); and (3) Duke Progress' right to recover certain environmental costs and expenses incurred in connection with the Joint Units that are attributable to operations prior to the closing of the Proposed Transaction (collectively, the Excepted Provisions).<sup>19</sup>

#### **E. Amended Agreements**

13. As part of its 205 Filing, Duke Progress also proposes to amend the capacity charge formula rates in the following wholesale power sales agreements to provide for the inclusion of the acquisition adjustment that Duke Progress will pay for the Joint Units: (1) Power Supply Coordination Agreement between Duke Progress and the Public Works Commission of the City of Fayetteville, North Carolina, designated as Duke Progress Rate Schedule No. 184; (2) North Carolina Electric Membership Corporation and Duke Progress Second Amended and Restated Power Supply and Coordination Agreement, designated as Duke Progress Rate Schedule No. 182; (3) Full Requirements

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<sup>17</sup> *Id.* at 20.

<sup>18</sup> *Id.* at 28.

<sup>19</sup> *Id.* at 26-27.

Power Purchase Agreement between Duke Progress and French Broad Electric Membership Cooperative, designated as Duke Progress Rate Schedule No. 195; (4) Full Requirements Power Purchase Agreement between the City of Camden, South Carolina and Duke Progress, designated as Duke Progress Rate Schedule No. 197; and (5) Second Amended and Restated Partial Requirements Service Agreement between Duke Progress and Piedmont Electric Membership Corporation, designated as Duke Progress Rate Schedule No. 172.<sup>20</sup>

14. Duke Progress states that, to incorporate the acquisition adjustment, Duke Progress is amending the capacity charge formula rates in these agreements to include the acquisitions adjustment (Account No. 114), the amortization of plant acquisition adjustment (Account No. 115), and expense Account No. 406, amortization of utility plant acquisition adjustment. Duke Progress states that these same formula rate provisions are included in the Full Requirements Agreement. Furthermore, Duke Progress states that these amendments do not affect the stated capacity charges in place in these power purchase agreements prior to their conversion to capacity charge formula rates.<sup>21</sup> Duke Progress states that it has engaged in outreach efforts with these five wholesale customers to discuss the Proposed Transaction and its impacts and that it believes that these customers will not oppose the Proposed Transaction and the Amended Agreements.<sup>22</sup>

15. Finally, Duke Progress notes that Commission authorization to include the acquisition adjustment in rates charged under the Full Requirements Agreement and the

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<sup>20</sup> *Id.* at 29.

<sup>21</sup> Duke Progress states that the Fayetteville agreement already includes a capacity charge formula rate and that the other four agreements convert to capacity charge formula rates between 2016 and 2022.

<sup>22</sup> *Id.* at 29. We note that Duke Progress has other agreements with wholesale customers for which it has not proposed amendments to recover the acquisition adjustment for the Joint Units. These customers include Town of the Black Creek, the Town of Lucama, the Town of Sharpsburg, the Town of Stantonsburg, the Town of Winterville, Haywood Electric Membership Corporation, and the Town of Waynesville. Duke Progress states that it serves these customers under contracts with stated capacity rates and that these customers will see “no increase in demand-related costs,” including the acquisition adjustment, as a result of the Proposed Transaction. Jennifer German Test., Ex. DEP-300 at P 34 (German Test.).

Amended Agreements for the five wholesale customers described above is a condition precedent to the Proposed Transaction.<sup>23</sup>

## **II. Notice of Filings and Responsive Pleadings**

16. Notice of the 203 Application was published in the *Federal Register*, 79 Fed. Reg. 62,612 (2014), with interventions and protests due on or before October 31, 2014. Timely motions to intervene were filed by Power Agency, Town of Stantonsburg, North Carolina, Town of Lucama, North Carolina, Town of Sharpsburg, North Carolina, North Carolina Electric Membership Corporation, Greenville Utilities Commission, the Public Staff of the North Carolina Utilities Commission, and the South Carolina Office of Regulatory Staff. Town of Black Creek, North Carolina (Town of Black Creek) filed an out-of-time motion to intervene. No protests were filed.

17. Notice of the 205 Filing was published in the *Federal Register*, 79 Fed. Reg. 62,612-13 (2014), with interventions and protests due on or before October 31, 2014. Timely motions to intervene were filed by Power Agency, North Carolina Electric Membership Corporation, Greenville Utilities Commission, the Public Staff of the North Carolina Utilities Commission, and the South Carolina Office of Regulatory Staff. No protests were filed.

## **III. Discussion**

### **A. Procedural Issues**

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2014), the timely, unopposed motions to intervene serve to make the entities that filed them parties to these proceedings. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2014), we will grant Town of Black Creek's late-filed motion to intervene in Docket No. EC15-9-000, given its interest in the proceeding, the early state of the proceeding, and the absence of undue prejudice or delay.

### **B. Authorization of Proposed Transaction Under Section 203**

#### **1. Standard of Review Under Section 203**

19. Section 203(a)(4) of the FPA requires the Commission to approve a transaction if it finds that the transaction "will be consistent with the public interest."<sup>24</sup> The

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<sup>23</sup> 205 Filing at 6.

Commission's analysis of whether a transaction is consistent with the public interest generally involves the consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.<sup>25</sup> Section 203(a)(4) also requires the Commission to find that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge or encumbrance will be consistent with the public interest."<sup>26</sup> The Commission's regulations establish verification and informational requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or pledge or encumbrance of utility assets.<sup>27</sup>

**a. Effect on Horizontal Competition**

**i. Duke Progress' Analysis**

20. Duke Progress contends that the Proposed Transaction raises no horizontal market power concerns in the Duke Progress BAA, where the Joint Units are located. To this point, it asserts that the Proposed Transaction does not enable Duke Progress to control additional generating capacity in this market because existing contractual arrangements with Power Agency already give Duke Progress the ability to exercise operational and dispatch control over the Joint Units.<sup>28</sup>

21. Specifically, Duke Progress notes that the Power Coordination Agreement gives Duke Progress the sole responsibility for scheduling and dispatching the available capacity of the jointly-owned facilities to serve the combined loads of Duke Progress and Power Agency.<sup>29</sup> Additionally, Duke Progress states that the Power Coordination Agreement provides that Duke Progress must purchase any output from the Joint Units that Power Agency does not use to meet its hourly resource demand or to make sales to third parties. The Power Coordination Agreement also states that Duke Progress has the

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<sup>24</sup> 16 U.S.C. § 824b(a)(4) (2012).

<sup>25</sup> See Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,111.

<sup>26</sup> 16 U.S.C. § 824b(a)(4) (2012).

<sup>27</sup> 18 C.F.R. § 33.2(j) (2014).

<sup>28</sup> 203 Application at 9-10.

<sup>29</sup> *Id.* at 11.

right to match the terms and conditions of any sale that Power Agency proposes to make to entities other than the Participants in Power Agency. Thus, Duke Progress asserts that the Power Coordination Agreement provides Duke Progress with the contractual right to purchase all of the output from the Joint Units in excess of the needs of Power Agency.<sup>30</sup> Because the Power Coordination Agreement gives Duke Progress the exclusive right to operate and dispatch the Joint Units and imposes upon it an obligation to meet all of the additional requirements of Power Agency, for purposes of the Commission's market power analyses, Duke Progress states that it has consistently treated the Joint Units as if they were fully under its control and the full load of the Participants in Power Agency as Duke Progress' load.<sup>31</sup>

22. Duke Progress further notes that, in conjunction with its acquisition of the Joint Units, Duke Progress will assume the obligation to meet the full electricity requirements of Power Agency's Participants pursuant to the Full Requirements Agreement. Thus, according to Duke Progress, pursuant to this arrangement, Duke Progress will assume ownership of an additional 700 MW of capacity but will also assume the obligation to serve the 700 MW of Power Agency load that currently is met by Power Agency's Joint Units capacity entitlement. Accordingly, Duke Progress contends that, for the purpose of the Commission's market power analysis, the Commission should view the Joint Units' output as fully committed to meeting Duke Progress' obligation to serve Power Agency's load. Duke Progress states that the Commission consistently has ruled that assessments of an applicant's market power must consider such contractual commitments.<sup>32</sup>

23. Duke Progress states that, even if the Joint Units were not currently considered to be under Duke Progress' control, the long-term full requirements commitments that Duke Progress will undertake as part of the Proposed Transaction mean that the only potential change in its market presence that could result from the Proposed Transaction is that Duke Progress will control uncommitted capacity from the Joint Units during those limited-off peak hours when the available output of those units may exceed the loads of Power Agency's Participants. Duke Progress asserts that, in such a situation, it would own only slightly more uncommitted capacity because the amount of capacity that Duke Progress is acquiring will be fully offset by the amount of the additional load it has

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<sup>30</sup> *Id.* at 12.

<sup>31</sup> *Id.* at 12-13.

<sup>32</sup> *Id.* at 14 (citing 18 C.F.R. § 33.3(c)(4)(i)(A) (2014); *AES Corp.*, 137 FERC ¶ 61,122, at P 24 (2011)).

agreed to serve under the Full Requirements Agreement except when Power Agency's load falls below its hourly generation entitlement, a situation that "rarely occurs."<sup>33</sup>

**ii. Commission Determination**

24. In analyzing whether a transaction will adversely affect competition, the Commission examines the effects on concentration in the generation markets or whether the transaction otherwise creates an incentive and ability to engage in behavior harmful to competition, such as withholding of generation (horizontal concerns).

25. We find that the Proposed Transaction will not result in Duke Progress' control of any additional generating capacity in its BAA. Duke Progress has demonstrated that, under its existing agreements with Power Agency, Duke Progress already exercises operational and dispatch control of the full output of the Joint Units. Moreover, Power Agency's load requirements after the closing of the Proposed Transaction will be roughly equivalent to the output of the Joint Units. Consequently, we find that the Proposed Transaction does not have an adverse effect on horizontal competition.<sup>34</sup>

**b. Effect on Vertical Competition**

**i. Duke Progress' Analysis**

26. Duke Progress states that the Proposed Transaction will have no adverse effect on vertical market power. It concludes that a vertical market power analysis is unnecessary in the instant case because the Proposed Transaction will not result in Duke Progress owning or controlling any new entities that provide inputs to electricity products or electric generation products. Further, Duke Progress asserts that the Proposed Transaction does not involve the transfer of any transmission facilities. Finally, Duke Progress states that open access service over its transmission facilities is available pursuant to the rates and terms of its Open Access Transmission Tariff (OATT) on file with the Commission, which eliminates any concern about transmission-related vertical market power.<sup>35</sup>

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<sup>33</sup> *Id.* at 15.

<sup>34</sup> See *Bangor Hydro Electric Co.*, 144 FERC ¶ 61,030, at P 11 (2013) (finding no impact on horizontal concentration because the amount of generating capacity owned or controlled by applicants and their affiliates would not change as a result of the transaction).

<sup>35</sup> 203 Application at 19.

**ii. Commission Determination**

27. As the Commission has previously found, transactions that combine electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel) can harm competition if the transaction increases an entity's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, by denying rival entities access to inputs or by raising their input costs, an entity created by a transaction could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market.<sup>36</sup>

28. The Commission finds that the Proposed Transaction does not raise any vertical market power concerns. The Proposed Transaction does not involve any transmission assets or other inputs to electricity generation such as fuel supply or transportation facilities or new sites for generation. Thus, no change in control over electric transmission assets will occur as a result of the Proposed Transaction, and the Proposed Transaction will not increase Duke Progress' ability to erect barriers to entry.

**c. Effect on Rates**

**i. Duke Progress' Analysis**

29. Duke Progress argues that the Proposed Transaction will not have an adverse impact on wholesale requirements customers because, consistent with Commission policy and precedent, Duke Progress commits to hold its wholesale requirements customers and its transmission customers harmless from transaction-related costs for a period of five years after the Proposed Transaction is consummated, absent a filing under section 205 demonstrating that the transaction-related benefits exceeded the transaction-related costs.<sup>37</sup>

30. Duke Progress acknowledges that the Proposed Transaction will affect wholesale rates, as Duke Progress is acquiring about 701 MW of capacity at a cost of \$1.2 billion, which includes an acquisition adjustment. However, in this case, Duke Progress projects that its existing wholesale requirements customers will experience an overall rate decrease resulting from the energy-related cost savings that will result from Duke Power's acquisition of Power Agency's ownership interests in the nuclear units. As noted above, in Docket No. ER15-74-000, Duke Progress seeks Commission authorization to "put the full purchase price of the Joint Units, including the acquisition

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<sup>36</sup> *Exelon Corp.*, 138 FERC ¶ 61,167, at P 112 (2012).

<sup>37</sup> 203 Application at 19.

adjustment, in wholesale rates based on [Duke Progress'] demonstration that the Proposed Transaction 'is prudent and provides measurable demonstrable benefits to ratepayers.'"<sup>38</sup> Duke Progress states that this proceeding provides a full opportunity to review any changes to filed rates resulting from the Proposed Transaction and to determine whether the resulting rates are just and reasonable.<sup>39</sup>

31. As to transmission rates, Duke Progress states that no transmission facilities that are part of the bulk transmission system or included in transmission rate base will be transferred to Duke Progress. Hence, it claims that the Proposed Transaction will not cause Duke Progress to incur additional transmission costs that will flow through to customers under its OATT.<sup>40</sup>

## ii. Commission Determination

32. We find that that the Proposed Transaction will not have an adverse effect on rates. We emphasize at the outset that our analysis of rate effects under section 203 of the FPA differs from the analysis of whether rates are just and reasonable under section 205 of the FPA. Our focus here is on the effect that the Proposed Transaction will have on jurisdictional rates, whether that effect is adverse, and whether any adverse effect will be offset or mitigated by benefits that are likely to result from the transaction.<sup>41</sup>

33. With respect to transmission rates, we note that the Proposed Transaction does not involve the transfer of transmission facilities that are part of the bulk transmission system or included in transmission rate base. Therefore, the Proposed Transaction will not cause Duke Progress to incur additional transmission costs that will flow through to Duke Progress OATT customers.

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<sup>38</sup> *Id.* at 20 (citing *Florida Power & Light Co.*, 145 FERC ¶ 61,018, at P 60 (2013); *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at P 50, n.116 (2012)).

<sup>39</sup> *Id.* at 20-21.

<sup>40</sup> *Id.* at 21.

<sup>41</sup> *See, e.g.*, Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,123 (noting that an increase in rates "can be consistent with the public interest if there are countervailing benefits that derive from the transaction"); *see also ITC Midwest LLC*, 133 FERC ¶ 61,169, at P 24 (2010); *ALLETE, Inc.*, 129 FERC ¶ 61,174, at P 19 (2009); *Startrans IO, L.L.C.*, 122 FERC ¶ 61,307, at PP 25-28 (2008); *ITC Holdings Corp.*, 121 FERC ¶ 61,229, at PP 120-128 (2007).

34. Duke Progress concedes that the \$1.2 billion purchase price for the Proposed Transaction will affect wholesale rates and that the purchase price includes a \$343 million acquisition adjustment that Duke Progress is seeking to recover in rates charged under the Full Requirements Agreement and the Amended Agreements. While the Commission historically has not permitted rate recovery of acquisition adjustments, it has stated on numerous occasions that if an applicant seeks recovery of an acquisition adjustment associated with a section 203 transaction, it must be able to demonstrate in a proceeding under section 205 of the FPA that its acquisition was “prudent and provides measurable, demonstrable benefits to ratepayers.”<sup>42</sup> As noted in the 205 Filing, Duke Progress is seeking rate recovery for the full purchase price of the Joint Units, including the acquisition adjustment.<sup>43</sup> Consistent with our acceptance of the Full Requirements Agreement and the Amended Agreements and our approval of the inclusion of the acquisition adjustment in those wholesale rate agreements, as discussed below, we find that the Proposed Transaction will not have an adverse effect on wholesale rates. We note that Duke Progress has only sought to recover its acquisition adjustment from Power Agency pursuant to the Full Requirements Agreement and from the five wholesale customers that are parties to the Amended Agreements. We also note that no wholesale customer has argued that the Proposed Transaction will have an adverse impact on rates.<sup>44</sup>

35. We accept Duke Progress’ commitment to hold its wholesale requirements and transmission customers harmless with respect to all transaction-related costs for a period of five years. We interpret this commitment to apply to all transaction-related costs, including costs related to consummating the Proposed Transaction and transition costs.<sup>45</sup> Transaction-related costs do not include any acquisition adjustment, such as the one associated with the purchase of the Joint Units, which we address separately below.

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<sup>42</sup> *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at P 50 & n.116 (2012) (citing *Minnesota Power & Light Co.*, 43 FERC ¶ 61,104, at 61,342, *reh’g denied*, 43 FERC ¶ 61,502 (1988); *Duke Energy Moss Landing LLC*, 83 FERC ¶ 61,318, at 62,304 (1998); *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,020, at P 32 (2005)).

<sup>43</sup> 205 Filing at 5, 30.

<sup>44</sup> See *ALLETE, Inc.*, 129 FERC ¶ 61,174 at P 20.

<sup>45</sup> See, e.g., *Exelon Corp.*, 138 FERC ¶ 61,167 at P 118.

36. The Commission has established that, where applicants make hold harmless commitments in the context of section 203 transactions, in order to recover transaction-related costs, applicants must demonstrate offsetting benefits at the time they apply to recover those costs. The Commission has clarified its procedures for recovery of such costs under FPA sections 203 and 205.<sup>46</sup> Consistent with those clarifications, and given Duke Progress' commitment to hold its wholesale requirements and transmission customers harmless from transaction-related costs, if Duke Progress seeks to recover transaction-related costs incurred prior to the consummation of the Proposed Transaction or in the five years after the consummation of the Proposed Transaction, then Duke Progress must make that filing in a new FPA section 205 docket<sup>47</sup> and submit that same filing as a concurrent informational filing in this FPA section 203 docket.<sup>48</sup> The Commission will notice the new section 205 filing for public comment.

37. In the FPA section 205 proceeding, the Commission will determine first, whether Duke Progress has demonstrated offsetting savings, supported by sufficient evidence, to customers served under Commission jurisdictional rate schedules such that recovery of transaction-related costs is consistent with the hold harmless commitment and, second, whether the resulting new rate is just and reasonable in light of all the other factors underlying the proposed new rate. In the FPA section 205 filing, Duke Progress must: (1) specifically identify the transaction-related costs it is seeking to recover; and (2) demonstrate that those costs are exceeded by the savings produced by the Proposed Transaction. Duke Progress must show that the proposed rate is just and reasonable in addition to providing appropriate evidentiary support, such as reasonable documentation and estimates of the costs avoided, demonstrating that transaction-related costs have been offset by transaction-related savings in order to recover those transaction-related costs and comply with its hold harmless commitment. Those savings must be realized prior to, or concurrent with, any authorized recovery of transaction-related costs, and cannot be based on estimates or projections of future savings, but must be based on a demonstration of actual transaction-related savings realized by jurisdictional customers.<sup>49</sup> The Commission will consider rates not to be "just and reasonable" if they include recovery

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<sup>46</sup> *Exelon Corp.*, 149 FERC ¶ 61,148, at PP 106-109 (2014).

<sup>47</sup> The Commission will not authorize the recovery of transaction-related costs in an annual informational filing under existing formula rates.

<sup>48</sup> Upon receipt, the Commission will not act on or notice the concurrent informational filing.

<sup>49</sup> *See Audit Report of National Grid, USA*, Docket No. FA09-10-000 (Feb. 11, 2011) at 55; *see also Ameren Corp.*, 140 FERC ¶ 61,034, at PP 36-37 (2012).

of costs subject to a hold harmless commitment made in connection with an FPA section 203 application and if applicants fail to show offsetting savings due to the transaction.<sup>50</sup>

The Commission will be able to monitor Duke Progress' hold harmless commitment under its authority under section 301(c) of the FPA<sup>51</sup> and the books and records provision of the Public Utility Holding Company Act of 2005.<sup>52</sup> Moreover, the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.<sup>53</sup>

**d. Effect on Regulation**

**i. Duke Progress' Analysis**

38. According to Duke Progress, the Proposed Transaction will not have an adverse impact on regulation, at either the federal or state level. With regard to federal regulation, Duke Progress explains that the Proposed Transaction will not diminish the Commission's regulatory authority because the Proposed Transaction involves a transfer of assets from Power Agency, which is not subject to the Commission's jurisdiction, to Duke Progress. Duke Progress states that it will remain a "public utility" as defined in FPA section 201(e) and will continue to be subject to the Commission's FPA jurisdiction.<sup>54</sup> Further, Duke Progress asserts that the Commission will have jurisdiction over wholesale sales from the Joint Units after the Proposed Transaction closes. With regard to state regulation, Duke Progress states that it will continue to be subject to regulation by the North Carolina Commission and the South Carolina Commission.

**ii. Commission Determination**

39. We find no evidence that either state or federal regulation will be impaired by the Proposed Transaction. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap at the federal or state

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<sup>50</sup> *Exelon Corp.*, 149 FERC ¶ 61,148 at P 107.

<sup>51</sup> 16 U.S.C. § 825 (2012).

<sup>52</sup> Public Utility Holding Company Act of 2005, 42 U.S.C. § 16541 *et seq.* (2012).

<sup>53</sup> *See, e.g., Exelon Corp.*, 138 FERC ¶ 61,167 at P 119; *PPL Corporation and E.ON U.S. LLC*, 133 FERC ¶ 61,083, at P 26 (2010).

<sup>54</sup> 203 Application at 21 (citing 16 U.S.C. § 824(e) (2012)).

level.<sup>55</sup> We find that the Proposed Transaction will not create a regulatory gap at the federal level because the Commission will retain its regulatory authority over Duke Progress after the Proposed Transaction is consummated. Nor will the Proposed Transaction create a regulatory gap at the state level because Duke Progress will continue to be subject to regulation by the North Carolina Commission and the South Carolina Commission.

40. In the Merger Policy Statement, the Commission stated that it ordinarily will not set the issue of the effect of a transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission stated that it may set the issue for hearing, and that it will address such circumstances on a case-by-case basis.<sup>56</sup> We note that no state commission has raised any concerns regarding the effect of the Proposed Transaction on regulation.

**e. Cross-Subsidization**

**i. Duke Progress' Analysis**

41. Duke Progress asserts that, based on the facts and circumstances that are known or that are reasonably foreseeable, the Proposed Transaction will not now or in the future result in: (1) transfers of facilities between a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, and an associate company; (2) new issuances of securities by traditional public utility associate companies that have captive customers or that own or provide transmission service over jurisdictional transmission facilities, for the benefit of an associate company; (3) new pledges or encumbrances of assets of a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; or (4) new affiliate contracts between non-utility associate companies and traditional public utility associate companies that have captive customers or that own or provide transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review pursuant to FPA sections 205 and 206.<sup>57</sup>

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<sup>55</sup> Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124.

<sup>56</sup> *Id.* at 30,125.

<sup>57</sup> 203 Application at 23-24.

**ii. Commission Determination**

42. Based on the representations made by Duke Progress, we find that the Proposed Transaction will not result in cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company. We note that no party has argued otherwise.

43. When a controlling interest in a public utility is acquired by another company, whether a domestic company or a foreign company, the Commission's ability to adequately protect public utility customers against inappropriate cross-subsidization may be impaired absent access to the parent company's books and records. Section 301(c) of the FPA gives the Commission authority to examine the books and records of any person who controls, directly or indirectly, a jurisdictional public utility insofar as the books and records relate to transactions with or the business of such public utility.<sup>58</sup> The approval of this transaction is based on such examination ability.

**f. Accounting**

**i. Duke Progress Analysis**

44. Duke Progress provided preliminary journal entries reflecting the purchase of the Joint Units. Duke Progress' proposed journal entries clear the purchase through Account 102, and record the original cost and related accumulated depreciation of the acquired assets on its books, consistent with Electric Plant Instruction No. 5.<sup>59</sup> Duke Progress proposes to recognize an acquisition adjustment in Account 114, Electric Plant Acquisition Adjustments, for the amounts paid in excess of the depreciated original cost of the assets acquired, which it requests to amortize to Account 406, Amortization of Electric Plant Acquisition Adjustments, over a 29 year period.

**ii. Commission Determination**

45. Under the Uniform System of Accounts, a public utility is required to amortize acquisition adjustments to Account 425, Miscellaneous Amortization, unless it has obtained, or reasonably expects to obtain, authorization to recover the acquisition adjustment by regulatory authorities having rate jurisdiction. Therefore, consistent with the rate treatment of the acquisition adjustment discussed below, we approve Duke Progress' proposed accounting to amortize the acquisition adjustment to Account 406.

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<sup>58</sup> 16 U.S.C. § 825(c) (2012).

<sup>59</sup> 18 C.F.R. pt 101 (2014).

46. In addition, Duke proposes to recognize an asset retirement obligation (ARO) asset and liability of approximately \$263 million related to the decommissioning of the assets acquired by debiting Account 101, Electric Plant In Service, and crediting Account 230, Asset Retirement Obligations, consistent with General Instruction No. 25.<sup>60</sup> Finally, Duke proposes to recognize the receipt of approximately \$265 million in decommissioning funds transferred from the Power Agency in Account 128, Other Special Funds.

**g. Other Obligations**

47. Order No. 652 requires that sellers with market-based rate authority timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.<sup>61</sup> To the extent that the foregoing authorization results in a change in status, Duke Progress is advised that it must comply with the requirements of Order No. 652. In addition, Duke Progress shall make any appropriate filings under section 205 of the FPA to implement the Proposed Transaction.

48. Information and/or systems connected to the bulk power system involved in this Proposed Merger may be subject to reliability and cyber security standards approved by the Commission pursuant to FPA section 215. Compliance with these standards is mandatory and enforceable regardless of the physical location of the affiliates or investors, information databases, and operating systems. If affiliates, personnel or investors are not authorized for access to such information and/or systems connected to the bulk power system, a public utility is obligated to take the appropriate measures to deny access to this information and/or the equipment/software connected to the bulk power system. The mechanisms that deny access to information, procedures, software, equipment, and the like, must comply with all applicable reliability and cyber security standards. The Commission, NERC, or the relevant regional entity may audit compliance with reliability and cyber security standards.

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<sup>60</sup> *Id.*

<sup>61</sup> *Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority*, Order No. 652, FERC Stats. & Regs. ¶ 31,175, *order on reh'g*, 111 FERC ¶ 61,413 (2005). *See* 18 C.F.R. § 35.42 (2014).

### C. 205 Agreements

50. We accept the Full Requirements Agreement and the Amended Agreements, effective December 10, 2014, as requested. We discuss certain aspects of these agreements below.

#### 1. Acquisition Adjustment

##### a. 205 Filing

51. Duke Progress explains that the Proposed Transaction is “inextricably intertwined” with the Full Requirements Agreement that “directly correlates with the amount of capacity being acquired” from the Joint Units.<sup>62</sup> Accordingly, it asserts that the relevant benefits analysis is an evaluation of Duke Progress’ “overall wholesale rates with the [Proposed] Transaction (and recovery of the . . . acquisition adjustment)” compared to the overall wholesale rates without the Proposed Transaction.<sup>63</sup> To perform this analysis, Duke Progress evaluated its system revenue requirements over a 20 year period<sup>64</sup> with and without the Proposed Transaction.<sup>65</sup> Citing to the prepared testimony of its expert witness, Ms. Jennifer German, Duke Progress states that its benefits analyses demonstrate that the Proposed Transaction will provide significant fuel savings to its wholesale and retail customers.<sup>66</sup>

52. Ms. German states that the nuclear Joint Units provide the majority of the benefits associated with the Proposed Transaction. To support this assertion, Ms. German explains that the cost of fuel for nuclear energy is the lowest cost on a per MWh basis for

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<sup>62</sup> 205 Filing at 6.

<sup>63</sup> *Id.*

<sup>64</sup> Duke Progress acknowledges that the integrated resource planning horizon in the Carolinas to meet the load requirements and targeted reserve margin is typically 15 years. However, for purposes of the analysis in this proceeding, Duke Progress explains that it used the standard long-term modeling run of 20 years (2016 to 2035) because, with the exception of the Harris Unit’s license expiration on October 24, 2046, the other four Joint Units will retire between around 2034 and 2036. German Test. at 5-6.

<sup>65</sup> 205 Filing at 6-7.

<sup>66</sup> *Id.* at 33.

base load generation that is available in the market today.<sup>67</sup> Specifically, she explains that, even with recent low natural gas prices, the most efficient combined cycle plants (with an average heat rate of 7,000 Btu/kWh) on Duke Progress' system have fuel costs that are triple the cost for fuel for nuclear units on a per MWh basis.<sup>68</sup> Ms. German expects this price differential in fuel costs to increase. In particular, she cites to forecasts in the U.S. Energy Information Administration's Annual Energy Outlook 2014, which predicts Henry Hub 2016 prices to be \$4.41/MMBtu and to grow at 5 percent annually.<sup>69</sup> She explains that the bases for concluding that the Proposed Transaction results in fuel benefits are projected fuel costs per MWh for steam (coal), nuclear, and other generation for the period 2015 to 2035.<sup>70</sup>

53. Ms. German explains that another benefit associated with the nuclear units involved in the Proposed Transaction is that they can operate during extreme weather conditions, such as the polar vortex during the winter of 2014. She explains that during this period of extreme cold, natural gas prices soared due to transportation issues. She argues that because nuclear stations provide fuel certainty, they are not vulnerable to such fuel disruptions.<sup>71</sup>

54. Finally, with regard to the nuclear capacity procured in the Proposed Transaction, Ms. German explains that nuclear power station reliability is "unmatched" compared to generating facilities that utilize other forms of fuel.<sup>72</sup> Further, she advises that the five-year average capacity factors (2009-2013) for Brunswick 1, Brunswick 2 and the Harris Unit were 90.74 percent, 86.22 percent, and 91.86 percent, respectively.

55. Ms. German also addresses customer benefits associated with the acquisition of the two coal-fired assets, the Mayo Plant and the Roxboro Unit. She explains that having coal generation as an option in the generation mix provides for fuel diversification and

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<sup>67</sup> German Test. at 6 (citing Ex. DEP-301).

<sup>68</sup> *Id.* at 7.

<sup>69</sup> *Id.* at 8 (citing Annual Energy Outlook 2014, U.S. Energy Information Administration (May 7, 2014), *available at* [http://www.eia.gov/forecasts/aeo/tables\\_ref.cfm](http://www.eia.gov/forecasts/aeo/tables_ref.cfm)).

<sup>70</sup> *Id.* (citing Ex. DEP-303).

<sup>71</sup> *Id.* at 10.

<sup>72</sup> *Id.*

opportunities for fuel switching under economic dispatch. To this point, she explains that when Duke Progress dispatches its generation resources from the least-cost units to the most expensive, it first dispatches the nuclear units, followed by either coal units or combined cycle natural gas units. She explains that the advantage of coal units is that when natural gas prices rise, Duke Progress can meet load requirements with coal generation, a benefit that allowed Duke Progress to temper the effects of high natural gas prices during the winter of 2014.<sup>73</sup>

56. Further, she explains that another benefit of the acquisition of coal generating capacity is the availability of fuel and the historically stable price of coal.<sup>74</sup> Specifically, she states that, based on current production levels, the U.S. has enough estimated recoverable reserves of coal to last more than 200 years.<sup>75</sup> Finally, Ms. German explains that the Mayo unit and the Roxboro unit 4 are reliable and efficient coal units capable of achieving heat rates of 9,662 BTU/kWh and 9,774 BTU/kWh, respectively.

57. To perform the benefits analysis of the Proposed Transaction, Duke Progress relied upon data from the most current integrated resource plan that Duke Progress filed with the North Carolina Commission and the South Carolina Commission in September 2014. Ms. German explains that integrated resource plan preparation begins with the collection of data that are integral to the planning process such as load forecasts, fuel price forecasts,<sup>76</sup> generating unit data, demand side management assumptions, and wholesale purchases and sales information, including renewable generation and other non-utility generation.<sup>77</sup>

58. With regard to the resource planning process and how it relates to the Proposed Transaction, Ms. German explains that for planning purposes, under the current arrangements with Power Agency, Duke Progress assumes Power Agency's full

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<sup>73</sup> *Id.* at 11.

<sup>74</sup> *Id.* at 12.

<sup>75</sup> *Id.* at 13 (citing U.S. Energy Information Administration, "What is the role of coal in the United States?", *available at* [http://www.eia.gov/energy\\_in\\_brief/article/role\\_coal\\_us.cfm](http://www.eia.gov/energy_in_brief/article/role_coal_us.cfm)).

<sup>76</sup> Ms. German explains that Duke Progress relied on Energy Ventures Analysis, Inc., to provide fuel price data and other information for the 2014 integrated resource plan. *Id.* at 23.

<sup>77</sup> *Id.* at 22.

requirements in its load forecast. In turn, the production cost modeling for the integrated resource plan assumes that 100 percent of the jointly-owned units' capacity will be available to serve the Duke Progress system load, which is similar to how Duke Progress' system works in real time.<sup>78</sup> She explains that, on a very high level, the evaluation of the asset purchase consists of a comparison of the cost-of-service for Duke Progress before the closing of the Proposed Transaction (the "net" view) with the estimated cost-of-service after the consummation of the Proposed Transaction (the "gross" view).<sup>79</sup>

59. Ms. German explains that the analysis to evaluate the economics of the Proposed Transaction relies on a cost-of-service model that brings together capacity (or demand-related) cost estimates and energy-related costs to produce a total revenue requirement, including rates for both capacity and energy.<sup>80</sup> Her model uses various inputs including the base case resource plan as identified in the annual integrated resource plan, to run an hourly production cost model using the application PROSYM.<sup>81</sup> Specifically, she states that the PROSYM results provided the total cost of fuel and purchased power, the megawatt-hours by fuel type used to determine production related variable operations and maintenance costs, and off-system sales for which Duke Progress' native load receives revenue credits.<sup>82</sup> According to Ms. German, the PROSYM production cost model provided the generation data and cost information that were inputs to a statistical analysis system program called the Energy Classification Allocation Program.<sup>83</sup> Ms. German explains that the Energy Classification Allocation Program provided generation and cost data for Power Agency's entitlement from the Joint Units to make adjustments in the production cost model to determine the net system costs (i.e., excluding Power Agency's share of generation and related costs).<sup>84</sup>

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<sup>78</sup> *Id.* at 23.

<sup>79</sup> *Id.* at 25.

<sup>80</sup> *Id.* at 26.

<sup>81</sup> More information on PROSYM is *available at* <http://www.ventyx.com/~~/media/files/brochures/market-analytics-data-sheet.ashx>.

<sup>82</sup> German Test. at 27.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 28.

60. According to Ms. German, the cost-of-service prior to the Proposed Transaction, the “net” view, consists of the existing Duke Progress return on and of rate base, system fuel costs, demand and energy related operating expenses, and forecasted load and energy. The cost-of-service after the Proposed Transaction, the “gross” view, includes all the costs of the system prior to the Proposed Transaction plus the full purchase price of the Joint Units, incremental fuel and operating expenses associated with the Joint Units, and factors in the additional load and energy resulting from the conversion of Power Agency’s partial requirements contract to the Full Requirements Agreement.<sup>85</sup>

61. Ms. German explains that once all demand and energy costs were incorporated in the cost-of-service models, both net and gross views, she calculated the before- and after-Proposed Transaction revenue requirements. She states that Duke Progress used the revenue requirements coupled with the load forecast to determine rates for demand on a price per kilowatt basis and for energy on a price per megawatt-hour basis as well as an all-in price per megawatt-hour<sup>86</sup> rate for Duke Progress for the years 2016 through 2035.<sup>87</sup> Ms. German concludes that, with the negotiated purchase price of \$1.2 billion for the Joint Units, as adjusted for a December 31, 2015 closing, the Proposed Transaction provides an overall net benefit for the Duke Progress system and for Duke Progress’

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<sup>85</sup> Ms. German avers that she has made adjustments to the cost-of-service after the transaction closes to: add to gross plant and accumulated depreciation Power Agency’s share of the jointly-owned assets; add Power Agency’s share of nuclear fuel to the nuclear fuel inventory balance; add Power Agency’s share of materials and supplies (spare parts inventory); adjust accumulated deferred income taxes to take into account future book/tax depreciation differences on Power Agency’s share of the jointly owned assets; include additional working capital to account for Duke Progress’ full ownership in the Joint Units; reflect incremental fixed O&M; reflect incremental depreciation expense; reflect incremental decommissioning expense; reflect incremental property taxes & insurance; reflect fuel and variable O&M for Power Agency’s share of the jointly owned assets; and include Power Agency’s full load (demand and energy) in the DEP system load. *Id.* at 29.

<sup>86</sup> Ms. German also simulated a separate set of revenue requirements for a federal carbon tax assumption starting in 2020. The all-in price per megawatt-hour rate for the Duke Progress system is called the CO<sub>2</sub> (carbon dioxide) Case in the studies.

<sup>87</sup> *Id.* at 30.

wholesale customers in a scenario that includes a price on CO<sub>2</sub> emissions and a scenario without a price on CO<sub>2</sub> emissions.<sup>88</sup>

62. Ms. German explains that the comparison of the revenue requirements over the 20 year study period between the net view of the cost-of-service and the gross view of the cost-of-service shows that the Proposed Transaction provides significant fuel savings. She explains that fuel savings accrue to the system because the majority of the energy produced by the Joint Units is generated by the nuclear generation at a lower fuel cost than the average system fuel cost. The results of the studies under the “CO<sub>2</sub>” and “No CO<sub>2</sub>” cases are summarized as follows:<sup>89</sup>

\$ in MM	System Benefit/(Cost) CO <sub>2</sub> Case	Wholesale Benefit/(Cost) CO <sub>2</sub> Case	System Benefit/(Cost) No CO <sub>2</sub> Case	Wholesale Benefit/(Cost) No CO <sub>2</sub> Case
Energy Related Savings	\$1,222	\$279	\$975	\$214
Demand Related Costs	(\$879)	(\$176)	(\$893)	(\$178)
Net Benefit	\$343	\$102	\$82	\$36

63. Ms. German explains that, assuming a closing of December 31, 2015, the net present value of the energy-related savings over the 20 year study period from 2016-2035 for existing wholesale customers, (including the five wholesale customers under the Amended Agreements) under the “CO<sub>2</sub> Case” is \$279 million, which will be somewhat offset by the net present value of increased demand-related costs of \$176 million, resulting in net savings of \$102 million. Under the “No CO<sub>2</sub> Case,” the net present value of the energy savings for wholesale customers is \$214 million, somewhat offset by demand-related increases of \$178 million resulting in an overall savings of \$36 million.<sup>90</sup>

64. Ms. German notes that these reduced energy-related costs will benefit all of Duke Progress’ wholesale customers because Duke Progress serves all of its wholesale customers pursuant to contracts with energy cost formulas that track the actual cost of fuel consumed. She also notes that energy savings grow over time and that the current

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<sup>88</sup> *Id.* at 32.

<sup>89</sup> *Id.* at 32-33 (citing Ex. DEP-311).

<sup>90</sup> *Id.* at 34.

forecast of system benefits associated with the transactions shows that energy savings completely offset demand-related costs beginning in 2020.<sup>91</sup>

65. While Ms. German acknowledges that Duke Progress did not have the option of serving Power Agency's load without acquiring the Joint Units, Duke Progress also evaluated a hypothetical scenario in which Duke Progress would enter into the Full Requirements Agreement and build new generation to serve this additional system load.<sup>92</sup> Specifically, Ms. German modeled the costs of building and operating an 866 MW "Advanced 2x2x1 Combined Cycle" unit.<sup>93</sup> Ms. German states that the results of this analysis indicate that over the period from 2016 to 2035, the "overall net present value of the revenue requirements for existing [Duke Progress] ratepayers are lower under the [Proposed] Transaction than under the Combined Cycle Alternative."<sup>94</sup>

#### **b. Commission Determination**

66. In the Merger Policy Statement, the Commission stated that if an FPA section 203 applicant "seeks to recover acquisition premiums through wholesale rates, we will address the issues in post-merger rate applications."<sup>95</sup> More recently, the Commission has stated that "any acquisition premium or acquisition adjustment associated with [a 203] [t]ransaction is not permitted to be included in rates absent Commission approval in a section 205 filing."<sup>96</sup>

67. The Commission's stated policy is that it may permit "acquisition adjustments in rate base for requirements rates if a utility can show that the investment decision is prudent and if it can demonstrate that the acquisition provides measurable benefits to ratepayers."<sup>97</sup> Such a demonstration could constitute a showing that "the excess paid

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<sup>91</sup> *Id.* at 36.

<sup>92</sup> *Id.* at 40.

<sup>93</sup> *Id.* at 41.

<sup>94</sup> *Id.* at 43.

<sup>95</sup> Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,126.

<sup>96</sup> *Florida Power & Light Co.*, 145 FERC ¶ 61,018, at P 60 (2013). *See also Exelon Corp.*, 138 FERC ¶ 61,167 at P 118.

<sup>97</sup> *Duke Energy Moss Landing LLC*, 83 FERC ¶ 61,318, at 62,304 (1998).

over the depreciated original cost results in specific dollar benefits to . . . customers. . . . that may include ‘decreases in rates, [or] improved services or economies in operation which are clearly related and solely the result of the acquisition.’”<sup>98</sup> Additionally, such benefits must be “tangible and nonspeculative.”<sup>99</sup> However, the Commission historically has been reluctant to permit recovery of acquisition adjustments. The Commission has stated that utilities have “never been guaranteed recovery of acquisition adjustment in rates” and that “recovery would be an exception to the general rule that utilities are only allowed recovery of the net depreciated original cost of public utility property.”<sup>100</sup> Nonetheless, the Commission has also stated that it would allow “acquisition adjustments in cost-based rates in extremely narrow circumstances where an applicant can demonstrate that the acquisition provides specific, measurable, and substantial benefits to ratepayers.”<sup>101</sup>

68. We have reviewed Duke Progress’ cost-of-service before the Proposed Transaction, all of the adjustments that Duke Progress proposed to make to cost-of-service after the Proposed Transaction’s closing, and the assumptions that Duke Progress utilized in its spreadsheet, including the escalation rates Duke Progress has used for coal, oil, natural gas, and nuclear fuel for the entire study period of 2016 through 2035. These adjustments and assumptions appear to be reasonable and demonstrate that the acquisition provides “specific, measurable, and substantial benefits to ratepayers.”<sup>102</sup>

69. Specifically, we accept Duke Progress’ assertion that the primary benefit from the Proposed Transaction is the fuel cost savings it will realize by adding nuclear generation to its fleet. The majority of the energy produced by the Joint Units is generated by the approximately 493 MW of nuclear capacity, which has a significantly lower fuel cost than Duke Progress’ average system fuel costs. In 2013, the average fuel cost for nuclear

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<sup>98</sup> *Pub. Serv. Co. of New Mexico*, 142 FERC ¶ 61,168, at P 25 (2013) (quoting *Montana-Dakota Utils. Co.*, 23 FERC ¶ 61,151, at 61,334 (1983) (quoting *United Gas Pipe Line Co.*, 25 FPC 26, at 64 (1961))).

<sup>99</sup> *Duke Energy Moss Landing LLC*, 86 FERC ¶ 61,227, at 61,818 (1999); *United Gas Pipe Line Co.*, 25 FPC at 64.

<sup>100</sup> *Duke Energy Moss Landing LLC*, 86 FERC ¶ 61,227 at 61,817.

<sup>101</sup> *Pub. Serv. Co. of New Mexico*, 142 FERC ¶ 61,168 at P 25; see also *Ameren Corp.*, 147 FERC ¶ 61,225, at P 25 (2014); *Wisconsin Pub. Serv. Corp.*, 144 FERC ¶ 61,093, at P 29 (2013).

<sup>102</sup> *Pub. Serv. Co. of New Mexico*, 142 FERC ¶ 61,168 at P 25.

generation in Duke Progress was \$7.30/MWh, while the average fuel cost for steam (coal) generation was \$44.62/MWh and the average fuel cost for natural gas/oil-fired combined cycle and combustion turbine plans was \$40.33/MWh.<sup>103</sup>

70. Duke Progress' analysis of benefits focuses on whether nuclear generation will continue to be the lowest cost fuel over the next 20 years, and whether the fuel savings will offset the increased costs associated with the Proposed Transaction, including the acquisition adjustment. As Ms. German notes, the Energy Information Administration projects that Henry Hub gas prices will grow at 5 percent annually, on average, beginning in 2016.<sup>104</sup> Duke Progress states that possible reasons for these increased gas prices include strong demand in the industrial sector, robust export volumes to Mexico, improving demand for liquefied natural gas, and a growing share of gas-fired power generation.<sup>105</sup> We note that, recognizing the difficulty in forecasting fuel prices 20 years in the future, Duke Progress considered a variety of scenarios and assumptions, including a no carbon cost scenario, and factoring in both low and high natural gas price forecasts. Each of these sensitivity analyses resulted in net benefits to Duke Progress' wholesale customers. We note that Duke Progress' demonstration indicates that the Proposed Transaction will result in at least \$82 million in benefits system-wide, with \$36 million in benefits accruing to all of Duke Progress' wholesale customers, net of additional costs to customers resulting from the rate recovery of the acquisition adjustment.<sup>106</sup>

71. We also found informative Duke Progress' consideration of a hypothetical scenario, in which it would build new generation (specifically, combined cycle units) to serve Power Agency's load. This hypothetical scenario showed that energy costs are substantially higher under the combined cycle alternative, and thus, the Proposed Transaction compares favorably to alternative purchases of capacity and energy in the Carolinas market. Moreover, we note that no wholesale customer of Duke Progress has disputed Duke Progress' calculation of benefits. Based on this determination, we can

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<sup>103</sup> German Test. at 7.

<sup>104</sup> *Id.* at 8 (citing Annual Energy Outlook 2014, U.S. Energy Information Administration (May 7, 2014), [http://www.eia.gov/forecasts/aeo/tables\\_ref.cfm](http://www.eia.gov/forecasts/aeo/tables_ref.cfm) (follow Summary Reference Case tables, "Table 13" hyperlink)).

<sup>105</sup> Jose Merino Test., Ex. DEP-400 at 16.

<sup>106</sup> Duke Progress' calculation of additional costs includes both the recovery of and a return on the acquisition adjustment. *See* German Test. at 25-26.

conclude that “the excess paid over the depreciated original cost results in specific dollar benefits to . . . customers.”<sup>107</sup>

72. We emphasize, however, that our acceptance of the inclusion of an acquisition adjustment here does not alter our strong resistance to allowing rate recovery of acquisition adjustments. Our determination here relies on the very specific circumstances surrounding this application and the detailed demonstration of “specific, measurable, and substantial benefits” to wholesale ratepayers, including Power Agency and the customers under the Amended Agreements. Additionally, while our primary consideration was the “specific, measurable, and substantial benefits,” we also gave considerable weight to the fact that Power Agency and the five wholesale customers did not protest the Full Requirements Agreement and Amended Agreements and did not take issue with Duke Progress’ analysis of the benefits that will be provided to Power Agency by the Proposed Transaction. As Power Agency’s Chief Operating Officer, Mr. Roy Jones, explains, in testimony submitted with the 205 Filing, the Proposed Transaction “will allow Power Agency to reduce for a time the wholesale electric service charges it bills to its members – charges that the members, in turn, recover from their own customers through their retail service rates.”<sup>108</sup> Thus, the Proposed Transaction “promotes Power Agency’s goal of securing for its members a balanced and reliable long-term power supply at a reasonable cost.”<sup>109</sup> We note that if Duke Progress seeks to recover the acquisition adjustment associated with the Proposed Transaction from wholesale customers other than the parties to the Full Requirements Agreement and the Amended Agreements, it must make a new filing pursuant to section 205 of the FPA to do so.

#### **D. Mobile-Sierra Standard of Review**

##### **1. 205 Filing**

73. As noted above, the Full Requirements Agreement states that the *Mobile-Sierra* “public interest” standard of review governs the Excepted Provisions, which pertain to: (1) a compensation provision relating to Power Agency’s right to reduce purchases should Duke Progress add nuclear capacity to its fleet; (2) the inclusion in Duke Progress’ rate base of the unamortized balance of the acquisition adjustment that Duke Progress will pay as part of the Proposed Transaction; and (3) Duke Progress’ right to recover certain environmental costs and expenses incurred in connection with the Joint

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<sup>107</sup> *Pub. Serv. Co. of New Mexico*, 142 FERC ¶ 61,168 at P 25.

<sup>108</sup> Roy Jones Test., Ex. DEP-1000 at 22.

<sup>109</sup> *Id.*

Units that are attributable to operations prior to the closing of the Proposed Transaction. The agreement provides that this standard applies to amendments or modifications by a party to the agreement, a non-party, or the Commission acting *sua sponte*.<sup>110</sup> Specifically, the language provides that:

to the extent a Party, any third party, or FERC acting *sua sponte* seeks to amend or otherwise modify, or requests FERC to amend or otherwise modify an Excepted Provision, the standard of review for any such proposed amendment or other modification shall be the “public interest” standard of review set forth in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), and as further defined in *Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1 of Snohomish County*, 554 U.S. 527 (2008), and *NRG Power Marketing, LLC v. Maine Public Utilities Commission*, 558 U.S. 165 (2010).<sup>111</sup>

## 2. Commission Determination

74. The *Mobile-Sierra* “public interest” presumption applies to an agreement only if the agreement has certain characteristics that justify the presumption. In ruling on whether the characteristics necessary to justify a *Mobile-Sierra* presumption are present, the Commission must determine whether the agreement at issue embodies either: (1) individualized rates, terms, or conditions that apply only to sophisticated parties who negotiated them freely at arm’s length; or (2) rates, terms, or conditions that are generally applicable or that arose in circumstances that do not provide the assurance of justness and reasonableness associated with arm’s-length negotiations. Unlike the latter, the former constitute contract rates, terms, or conditions that necessarily qualify for a *Mobile-Sierra* presumption. In *New England Power Generators Association v. FERC*, however, the D.C. Circuit determined that the Commission is legally authorized to impose a more rigorous application of the statutory “just and reasonable” standard of review on future changes to agreements that fall within the second category described above.<sup>112</sup>

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<sup>110</sup> Full Requirements Agreement § 16.2.

<sup>111</sup> *Id.*

<sup>112</sup> *Southwest Power Pool, Inc.*, 145 FERC ¶ 61,137, at P 8 (2013) (citing *New England Power Generators Association v. FERC*, 707 F.3d 364, 370-71 (D.C. Cir. 2013)).

75. We find that the Excepted Provisions of the Full Requirements Agreement involve contract rates to which, pursuant to the Full Requirements Agreement, the *Mobile-Sierra* “public interest” presumption applies with respect to modifications by a party to the agreement, a non-party, or the Commission acting *sua sponte*. The Excepted Provisions of the Full Requirements Agreement embody individualized rates, terms, or conditions that apply only to Duke Progress and Power Agency, the only parties to this agreement. Furthermore, these parties are unaffiliated. Additionally, Duke Progress states that Power Agency, the counterparty to the Full Requirements Agreement and the seller in the Proposed Transaction, carefully considered its position and its options in these negotiations and that the Full Requirements Agreement and the Proposed Transaction “are inextricably intertwined and were extensively negotiated at arms-length.”<sup>113</sup> Finally, Power Agency has not filed a protest in either proceeding.

## **E. Request for Waiver**

### **1. 205 Filing**

76. To the extent that it requires waiver, Duke Progress requests waiver of section 35.13 of the Commission’s regulations, including waiver of the full Period I-Period II data requirements and waiver of the requirements in section 35.13(a)(2)(iv) to determine if and the extent to which a proposed change constitutes a rate increase based on Period I-Period II rates and billing determinants. It argues that good cause exists for such waiver because the abbreviated statements and testimony submitted as attachments to the 205 Filing provide ample support for the reasonableness of the proposed formula rate and that detailed statements of Duke Progress’ cost of service are unnecessary where the proposed rates are formula and will be based on actual costs as reflected in Duke Progress’ FERC Form No. 1 filings.<sup>114</sup>

### **2. Commission Determination**

77. We grant Duke Progress’ request for waiver of the requirements under section 35.13 regarding the filing of a full Period I and Period II study, consistent with our prior approval of formula rates.<sup>115</sup>

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<sup>113</sup> 205 Filing at 4.

<sup>114</sup> *Id.* at 45.

<sup>115</sup> *Pub. Serv. Co. of N.M.*, 142 FERC ¶ 61,168, at P 29 (2013); *see also S. California Edison Co.*, 136 FERC ¶ 61,074, at P 30 (2011).

The Commission orders:

(A) The Proposed Transaction is hereby authorized, as discussed in the body of this order.

(B) Duke Progress must inform the Commission within 30 days of any material change in circumstances that departs from the facts the Commission relied upon in granting the 203 Application.

(C) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) Duke Progress, to the extent that it has not already done so, shall make any appropriate filings under section 205 of the FPA, as necessary, to implement the Proposed Transaction.

(G) Duke Progress shall account for the transaction in accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold, of the Uniform System of Accounts. Duke Progress shall submit its final accounting entries within six months of the date the transaction is consummated, and the accounting submission shall provide all the accounting entries and amounts related to the transaction along with narrative explanations describing the basis for the entries.

(H) Duke Progress shall notify the Commission within 10 days of the date on which the Proposed Transaction is consummated.

(I) The Full Requirements Agreement is hereby accepted for filing, effective December 10, 2014, as requested, as discussed in the body of this order.

(J) The Amended Agreements are hereby accepted for filing, effective December 10, 2014, as requested, as discussed in the body of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.