STAFF PROPOSAL
UM 1276
Investigation Into Performance-Based Ratemaking Mechanisms
December 19, 2007

Type of Mechanism: Utility incentive for eligible power purchase agreements (PPAs)

Incentive Level: 10 percent pre-tax adder on Oregon's share of forecasted costs of the PPA excluding fuel-related costs, with an annual true-up of the incentive for differences between forecasted and actual costs of the PPA for the previous year

Basis: As in PacifiCorp's and NIPPC's proposals, staff's incentive proposal is based on prior Commission decisions related to incentives for conservation. The 10 percent adder recognizes the risk mitigation value of PPAs, based on a similar value applied to conservation for determining cost-effectiveness.[1] The Commission explicitly recognized that the 10 percent adder accounts for the value of conservation in reducing risk and uncertainty.[2] However, as in PacifiCorp's proposal, the utility will receive an incentive in rates.

Eligibility Criteria:

- Only new PPAs and renewals as of the date of the Commission's authorization of the incentive are eligible. The PPA may be for energy, capacity, or both.
- The PPA must be selected under a competitive bidding process that conforms to the Commission's guidelines (Order No. 06-446),[3] and the PPA must be in lieu of a utility ownership option.[4]
- The PPA counter-party must absorb certain risks during project development (if the PPA is for a facility not yet completed), as well as explicit performance and operational risks.[5]
- Only contracts 25 MW or greater with a delivery term of three years or longer are eligible.[6]

[1] *See* ORS 469.649(3).
[2] *See* Order No. 94-590 (UM 551) at 14. Other benefits of acquiring PPAs include resource diversity (e.g., type and term), flexibility for resource planning and acquisition, and maintaining a competitive market.
[3] The Commission may consider requirements imposed by other states for the RFP process. *See* Order No. 06-446 at 9.
[4] The utility will not receive an incentive on turnkey projects. Staff is reviewing whether a self-build option should be required in order to compare relative costs and benefits of PPAs.
[5] *See* NIPPC's version of the CIM/pp proposal filed September 13, 2007, at 2.
[6] The Commission's competitive bidding guidelines do not preclude the utilities from specifying contract sizes and terms less than 100 MW and five years.

- Only PPAs contractually associated with specific assets by unit when in operation are eligible. Contracts may allow for economic displacement and include replacement power provisions.
- Contracts that utilities must enter into by law, including mandatory contracts under the Public Utility Regulatory Policies Act with Qualifying Facilities (QFs), are *not* eligible. However, FERC qualification of the counter-party as an exempt wholesale generator or a QF does not make the PPA ineligible for the proposed incentive.

Other Elements of the Proposal:

1) The utility will not consider the incentive in determining the RFP initial or final short-lists. To allow for consideration of risk mitigation benefits of PPAs, at a minimum the utility will include in the final short-list evaluation all PPAs whose price does not exceed 110 percent of the forward price curve and which otherwise qualify.[7, 8] The Commission will consider the incentive in any acknowledgment proceeding for the final RFP short-list.
2) The Independent Evaluator will provide a formal recommendation on the eligibility of the PPA for the incentive based on an evaluation of costs and benefits compared to utility ownership options. Regarding the extent to which the PPA absorbs asset ownership risks, the utility may demonstrate that Financial Accounting Standards Board Financial Interpretation 46(R), *Consolidation of Variable Interest Entities*, does not require consolidation of the PPA on the utility's balance sheet.
3) Any utility engaged in one or more PPAs under the incentive must report annually on its financial metrics and provide documentation demonstrating discernible effects on any imputed debt calculations and credit ratings.
4) The total incentive payments for any year under this mechanism will be limited to 1 percent of the utility's authorized retail revenues for the previous calendar year. After total incentive payments reach this level, the Commission will review the incentive mechanism for potential extension and modifications. The mechanism will continue up to the 1 percent cap while the Commission completes its review. At a minimum, the Commission will review the incentive within three years of the date the incentive is first included in the utility's rates.
5) The utility may seek recovery of the incentive through a rate case or annual net variable power cost update. Unless otherwise allowed by law or Commission order, PPAs are subject to a prudence review before PPA expenditures and incentives can be reflected in rates.

[7] A utility already may include bids above this threshold in its final short-list evaluation to ensure a sufficient number of bids, resource amounts and resource diversity. The utility also should consider how its Benchmark Resources compare to the forward price curve.
[8] Staff's proposed incentive should not be combined with NIPPC's proposed mechanism to discount PPAs in the competitive bidding process.

CERTIFICATE OF SERVICE

UM 1276

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to the following parties or attorneys of parties.

Dated at Salem, Oregon, this 21st day of December, 2007.

Kay Barnes

Kay Barnes
Public Utility Commission
Regulatory Operations
550 Capitol St NE Ste 215
Salem, Oregon 97301-2551
Telephone: (503) 378-5763

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Service List (Parties)

SUSAN K ACKERMAN ATTORNEY	9883 NW NOTTAGE DR PORTLAND OR 97229 susan.k.ackerman@comcast.net
JOHN DEMOSS AGENT FOR PTW	70620 HWY 97 MORO OR 97039 turbineone@earthlink.net
AF LEGAL & CONSULTING SERVICES	
ANN L FISHER ATTORNEY AT LAW	PO BOX 25302 PORTLAND OR 97298-0302 energlaw@aol.com
CITIZENS' UTILITY BOARD OF OREGON	
LOWREY R BROWN **(C)** UTILITY ANALYST	610 SW BROADWAY - STE 308 PORTLAND OR 97205 lowrey@oregoncub.org
JASON EISDORFER **(C)** ENERGY PROGRAM DIRECTOR	610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
ROBERT JENKS **(C)**	610 SW BROADWAY STE 308 PORTLAND OR 97205 bob@oregoncub.org
DAVISON VAN CLEVE PC	
MELINDA J DAVISON **(C)**	333 SW TAYLOR - STE 400 PORTLAND OR 97204 mail@dvclaw.com
DEPARTMENT OF JUSTICE	
MICHAEL T WEIRICH ASSISTANT ATTORNEY GENERAL	REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 michael.weirich@doj.state.or.us
ESLER STEPHENS & BUCKLEY	
JOHN W STEPHENS	888 SW FIFTH AVE STE 700 PORTLAND OR 97204-2021 stephens@eslerstephens.com

IDAHO POWER COMPANY	
KARL BOKENKAMP GENERAL MANAGER-POWER SUPPLY PLANNING	PO BOX 70 BOISE ID 83707-0070 kbokenkamp@idahopower.com
RIC GALE VP - REGULATORY AFFAIRS	PO BOX 70 BOISE ID 83707 rgale@idahopower.com
SANDRA D HOLMES	PO BOX 70 BOISE ID 83707-0070 sholmes@idahopower.com
BARTON L KLINE SENIOR ATTORNEY	PO BOX 70 BOISE ID 83707-0070 bkline@idahopower.com
LISA D NORDSTROM ATTORNEY	PO BOX 70 BOISE ID 83707-0070 lnordstrom@idahopower.com
GREGORY W SAID DIRECTOR - REVENUE REQUIREMENT	PO BOX 70 BOISE ID 83707 gsaid@idahopower.com
MCDOWELL & RACKNER PC	
WENDY MCINDOO	520 SW 6TH AVE STE 830 PORTLAND OR 97204 wendy@mcd-law.com
LISA F RACKNER ATTORNEY	520 SW SIXTH AVENUE STE 830 PORTLAND OR 97204 lisa@mcd-law.com
NORTHWEST ENERGY COALITION	
STEVEN WEISS SR POLICY ASSOCIATE	4422 OREGON TRAIL CT NE SALEM OR 97305 steve@nwenergy.org
NW INDEPENDENT POWER PRODUCERS	
ROBERT D KAHN EXECUTIVE DIRECTOR	7900 SE 28TH ST STE 200 MERCER ISLAND WA 98040 rkahn@nippc.org
OREGON PUBLIC UTILITY COMMISSION	
LISA C SCHWARTZ SENIOR ANALYST	PO BOX 2148 SALEM OR 97308-2148 lisa.c.schwartz@state.or.us

PACIFIC POWER & LIGHT MICHELLE R MISHOE LEGAL COUNSEL	 825 NE MULTNOMAH STE 1800 PORTLAND OR 97232 michelle.mishoe@pacificorp.com
PACIFICORP NATALIE HOCKEN VICE PRESIDENT & GENERAL COUNSEL	 825 NE MULTNOMAH SUITE 2000 PORTLAND OR 97232 natalie.hocken@pacificorp.com
PACIFICORP OREGON DOCKETS OREGON DOCKETS	 825 NE MULTNOMAH ST STE 2000 PORTLAND OR 97232 oregondockets@pacificorp.com
PORTLAND GENERAL ELECTRIC PATRICK HAGER RATES & REGULATORY AFFAIRS	 121 SW SALMON ST 1WTC0702 PORTLAND OR 97204 pge.opuc.filings@pgn.com
DOUGLAS C TINGEY **(C)**	121 SW SALMON 1WTC13 PORTLAND OR 97204 doug.tingey@pgn.com
PUBLIC UTILITY COMMISSION JUDY JOHNSON	 PO BOX 2148 SALEM OR 97308-2148 judy.johnson@state.or.us
RENEWABLE NORTHWEST PROJECT ANN ENGLISH GRAVATT	 917 SW OAK - STE 303 PORTLAND OR 97205 ann@rnp.org
RFI CONSULTING INC RANDALL J FALKENBERG **(C)**	 PMB 362 8343 ROSWELL RD SANDY SPRINGS GA 30350 consultrfi@aol.com