**NW ENERGY COALITION ALTERNATIVE PROPOSAL**
**UM 1276**
*December 21, 2007*

## I. Introduction

The NW Energy Coalition (NWEC) discussed in its December 4th comments its problems with the staff proposal. Chief among those was a concern that the parties have not adequately described the bias that is at issue, including the drivers and magnitude of any such bias.[1] We granted that there is a *small* bias that is generated by: (a) internal management pressure and incentive to grow the utility and to generate extra profit (between ratecases) from good management of owned resources; and, (b) a limited amount of uncompensated risk that a utility would bear in administering a Power Purchase Agreement (PPA)--the imputed debt issue. We believe these factors create some bias that is appropriate to address, but only a relatively small incentive is needed to overcome them.

## II. Value of Product Should Not Be Confused with Size of Incentive

Some parties seem to have conflated two unrelated issues: the value of the product offered by the PPA, and the amount of incentive needed to eliminate utility bias. We are comfortable, in lieu of more rigorous modeling that should occur in an IRP, in using a seat-of-the-pants value of 10% for the risk-reduction benefits a PPA can offer compared to a utility-owned asset. This comfort is based on the eligibility criteria proposed by staff.

However, staff and the utilities have mistakenly used this same 10% as the amount of incentive that must be provided to remove utility bias. But the two concepts

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[1] The parties rely mostly on the unproven and illogical assertion that a bias is created because utilities do not earn a return on PPA contracts. Staff states, for example, in its opening comments:

> ...staff is convinced that the primary barrier to PPA procurement is that utilities do not earn a return on PPA contracts. The logic is simple: under cost of service regulation, a utility's "profit" is the opportunity to earn a return on the rate base, and by purchasing a PPA in lieu of building a power plant it is forgoing the potential to earn some amount of profit. {There is also a footnote that notes a utility can earn some profit through operational benefits, but that is balanced by possibility of loss through operational problems.} (p.1)

However, investors have more than the two choices this argument implies. This argument assumes investors have only the opportunity to invest in new ratebase or to put it under their mattresses. But of course that's false. Investors can always find another similarly risky investment (another utility investment, perhaps), so there is almost zero opportunity cost between building and buying.

As for debt imputation, staff agrees this is not a large problem:

> ...the primary barrier to PPA procurement is not debt equivalency, but the loss of the return the utility would have earned had it built its own plant. (p. 7)

are completely unrelated. The amount of the incentive is not and should not be related to the value of the PPA. Instead the incentive should be an amount commensurate to overcoming any biasing drivers the utility faces. This amount can only be determined (or estimated) through an examination of those drivers and their magnitude. It is only necessary to provide enough incentive to ensure that the utilities score PPAs in an unbiased manner. This amount (the incentive) is unrelated to the value a PPA might bring.

**III. There is No Basis to Settle on a Large Incentive Level**

In our opinion, there is little basis to settle on the large incentive amount in staff's proposal. (We are concerned too that the incentive proposed by staff is so high that it would create a bias *against* utility ownership.) Barring evidence on the record of a large opportunity cost difference between building and buying, there is no real grounds for the Commission to approve such an incentive.[2]

In addition, when discussing the size of any incentive, it should not be necessary for Oregon ratepayers, by themselves to bear the burden of changing the behavior of a multi-state utility. Similarly, we should not expect this incentive to "work" for PacifiCorp if it is only applicable to Oregon's share of its load. If it is true that a 10% incentive is needed to eliminate utility bias, than it is doubtful that if only Oregon is participating, PacifiCorp's behavior would change.[3] Thus we would be wasting ratepayer money. If this incentive is a good idea, we should engage the other state Commissions to adopt it at the same time. Absent participation by a more significant share of the load, the incentive should not apply to PacifiCorp.

**IV. Proposal**

NW Energy Coalition recommends a 2-3% after-tax adder on Oregon's share of the total costs of the PPA; so long as for multi-state utilities a similar incentive is applied to most of the utility's load. That is, the incentive would apply to PGE immediately, but not to PacifiCorp unless joined by Utah, for example. This amount is consistent with the Income Opportunity proposal of PGE.

**V. Conclusion**

NW Energy Coalition recommends that to justify a large incentive like that in staff's proposal, parties need to provide more detailed evidence of the nature and magnitude of the bias they wish to address. So far, that has not occurred. Instead they have relied on an uncertain assumption regarding the opportunity cost between building

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[2] Parties should address, for example, the fact that two IOUs in Washington that face the same regulatory regime, Avista and PSE, have opted to acquire new renewable resources in different ways. PSE has sought to own windfarms, while Avista has leaned toward PPAs. Evidence such as this implies to us that other factors are involved than some large utility bias toward ownership, including a utility's existing portfolio, business model, and willingness to accept risk.

[3] By the same logic, if just Oregon's incentive *was* adequate to change PacifiCorp's behavior, it would indicate that the same incentive level is too high in the case of PGE.

and buying faced by an investor. In addition, they have not addressed the differential incentive level staff's proposal would place on single-state vs. multi-state utilities.

The Commission should provide a utility incentive in the range of 2-3% (after tax) on Oregon's share of the total costs of the PPA under the Staff's Eligibility Criteria and other proposed elements, applicable immediately to PGE, but not to PacifiCorp until a much greater participation by other states is included.

Thank you,

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# UM 1276
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## CERTIFICATE OF SERVICE

## UM 1276

On this 21st day of December, 2007 I certify that I served the NW Energy Coalition's UM1276 Alternative Proposal upon all parties of record in this proceeding by e-mail.

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