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July 12, 2006

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**Re: UM 1129**

Enclosed for filing in this matter are the original and five copies of PacifiCorp's Reply Brief on Phase II Issues. If you have any questions, please call.

Very truly yours,

John M. Eriksson

cc: Service List



Oregon
Washington
California
Utah
Idaho

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

**UM 1129**

| | |
|---|---|
| In the Matter of<br><br>PUBLIC UTILITY COMMISSION OF OREGON<br><br>Staff's Investigation Relating to Electric Utility Purchases from Qualifying Facilities | **PACIFICORP'S REPLY BRIEF ON PHASE II ISSUES** |

PacifiCorp (or the "Company") hereby submits its reply brief in response to other parties' opening briefs regarding Phase II issues.

## DISCUSSION

In this brief, PacifiCorp will address certain positions advocated by Staff and Weyerhaeuser-ICNU.[1] However, inasmuch as many of the positions and arguments of Staff and Weyerhaeuser-ICNU were known and addressed in PacifiCorp's Opening Brief, PacifiCorp has already argued its positions and will not reiterate all those arguments. Thus, failure to respond to positions and arguments contained in other parties' opening briefs is not to be construed as agreement with or acquiescence to those positions and arguments.[2]

In establishing guidelines for determining negotiated avoided cost rates, care should be taken to not set mandates that have not been shown to be feasible. For example, FERC

[1] PacifiCorp did not take a position on the question in Issue 12 regarding whether an Oregon utility should be required to enter into a new contract with a QF located in the service territory of a utility that has been relieved by FERC of the mandatory purchase obligation under PURPA, but concurs with the comments of Staff and Weyerhaeuser-ICNU that the Commission need not make a decision on this issue at this time. PacifiCorp also did not take a position in this phase on Issue 7 regarding insurance for projects under 200 kW.

[2] A number of guidelines set forth in Attachment A of Staff's Brief deal with issues that were addressed in the Phase I Compliance track of this case. (*see* Items 25, 32-34). PacifiCorp's positions on those issues have not changed.



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1 regulations require that the individual and aggregate value of QFs on a utility's system, and
2 the value of smaller capacity increments of QFs , "*to the extent practicable*" be taken into
3 account.[3] However, while determining such values might be "theoretically" possible
4 (Staff/1800, Schwartz/13), it has not been determined in this case whether it actually would
5 be practicable to quantify such values (which may also have offsetting costs). Thus, the
6
7 adoption of such guidelines should be with the same qualification of practicability contained
8 in the FERC regulations.

9 **1. Adjustments for reliability and dispatchability. [Issue 1.d]**

10 PacifiCorp opposes Staff's proposal that adjustments to avoided costs for
11 dispatchability should be made only during the utility's resource deficiency period. Staff
12 Brief at 5. Staff's argument for its proposal is simply that the avoided costs for the
13 sufficiency period are based on market purchases, not a proxy plant. While the methods used
14 for determining avoided costs during the sufficiency and deficiency periods are certainly
15 different, Staff's position fails to recognize that the cost of purchases in the market include
16 costs of dispatchability, such as costs for reserves and capacity, which are attributes of
17 dispatchability. For example, the Company must carry reserves for all qualifying facilities
18 located in the Company's control area. On the other hand, firm market purchases come with
19 capacity. Therefore, paying a qualifying facility market prices is not appropriate because it
20 would result in an overpayment to the QF since the Company will incur the cost of carrying
21
22 reserves for the qualifying facility. Staff's position is also discriminatory to those QF
23 resources that offer more flexibility or dispatchability benefits than less flexible QF
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25

26 [3] 18 CFR § 292.304(e)(2)(vi), (vii).

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resources. The Commission should not preclude the utilities from proposing adjustments to large QF prices based on dispatchability during the utility's period of resource sufficiency.

Staff also proposes the use of stochastic modeling, such as that used in integrated resource planning, to address dispatchability.[4] Staff Brief at 7; Attachment A Item 13.d. Stochastic modeling using IRP models would introduce considerable complexity, and require significant time. Particularly with Staff and QFs seeking to have the utilities provide proposed pricing in a timely manner, stochastic, IRP-based modeling should not be the only means allowed to model for dispatchability characteristics. Rather, the Commission should allow the utilities to use either that, or production cost modeling to determine adjustments that should be made regarding dispatchability.

**2. QFs should not receive an adder based on natural gas-price risk.**

Staff proposes that the avoided cost prices for QFs utilizing renewable resources, and combined heat and power QFs that are more efficient than the utility's proxy plant, should receive an adder to the extent avoided costs are not based on market index prices. Staff Brief at 9-10; Attachment A Item 19. Similarly, Weyerhaeuser-ICNU proposes that a CHP project should receive an adder, a "natural gas price mitigation value," if it can demonstrate that it uses natural gas more efficiently than the proxy plant. Weyerhaeuser-ICNU Brief at 22.

Staff's proposal is flawed because it is based on the unfounded assumption that the gas prices used to develop the standard avoided cost prices do not reflect any gas-price risk, and also because it is based on the faulty assumption that the utility would be completely exposed (not protected by sound risk management and hedging programs) to gas-price risk.

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[4] Staff also proposes a "sliding scale" modeling approach, which PacifiCorp does not oppose. Staff Brief at 6; Attachment A Item 13.c.



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As PacifiCorp pointed out in its Opening Brief with regard to gas market indexed pricing, that assumption is incorrect with respect to PacifiCorp. PacifiCorp Opening Brief at 14-15.

Weyerhaeuser-ICNU's gas price mitigation proposal is based on the idea that a CHP will operate more efficiently than the proxy plant, and that the reduced gas consumption will have a regional benefit of a lower gas price. Weyerhaeuser-ICNU/304, Beach/8. Weyerhaeuser-ICNU proposes that the CHP receive the same value "as a renewable generator that conserves an equal amount of natural gas." Weyerhaeuser-ICNU Brief at 22. Weyerhaeuser-ICNU's proposal is non-sensical and has no place in a discussion of avoided costs. Weyerhaeuser-ICNU's proposal is this: "Pay the QF the value of reducing the regional price of natural gas, which value would be reflected in the price of gas burned in a generation plant the utility will not build." Because the gas proxy plant is not being built, the utility will not realize the purported "gas price mitigation value" resulting from the operation of the CHP. Under Weyerhaeuser-ICNU's argument, the CHP project would already be receiving the value of the purported reduction in natural gas prices, and Weyerhaeuser-ICNU seems to want to receive that value twice. Weyerhaeuser-ICNU's gas price mitigation concept simply is not relevant to the utility's avoided cost.

**3. Negotiated avoided cost payments should be adjusted for any factors that impact the utility's avoided costs. [Issues 1.d, 1.f]**

Weyerhaeuser-ICNU's argument against the utilities being allowed to make adjustments to standard avoided costs based on "non-FERC approved factors" is based on the utilities having perfect foresight. Weyerhaeuser-ICNU Brief at 23-24 ("The utilities should not be permitted to impose factors in the negotiating process that they were unable to identify in this proceeding.") Neither the utilities nor the QFs should be held to that standard. If a

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characteristic of the QF impacts avoided cost, either up or down, it should be considered. Not allowing adjustments for items not on an approved list would also be based on the erroneous assumption that there can be no question as to whether the item fits within the list. Indeed, Staff's testimony reflects uncertainty as to whether certain adjustments (which no party disputes are appropriate), clearly fit within the FERC list of factors. Staff 1800/Schwartz/22 (consideration of integration costs "appears" to fit within two FERC adjustment factors); Staff/2300, Schwartz/12 (although there is no FERC factor that specifically addresses issue of transmission and distribution costs and savings, the Commission should consider that the issue "may" fall within FERC factor regarding "individual and aggregate value of energy and capacity.")

### 4. PacifiCorp's proposed methodology for line loss adjustments is reasonable. [Issue 1.d]

Staff and Weyerhaeuser-ICNU support the Company's proposed methodology for line loss adjustments, with the understanding or condition that the load center used in the Company's proximity approach looks at the load center closest to the QF, and compares that to the distance between the proxy plant and the load center nearest to the proxy plant. PacifiCorp confirms that its proximity analysis will be performed in such manner.

### 5. Avoided cost payments to intermittent resources should be reduced by integration costs. [Issue 3.a]

With the clarification in Staff's Brief that it is not recommending a project-specific approach for determining integration costs (Staff Brief at 17), PacifiCorp does not oppose Staff's proposed method for addressing integration costs.

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6. **"As available" deliveries should be priced at PacifiCorp's Schedule 37 off-peak prices. [Issue 1.c]**

Staff proposes that "as available" deliveries be priced based on "current" market prices, referring to PGE's use of quarterly forward market prices as an example.[5] Staff Brief at 4; Staff/1900, Chriss/2. While the FERC regulation clearly provides that "as available" sales are to be based on avoided costs "calculated at the time of delivery," the regulation does not define what is meant by that phrase. 18 CFR § 292.304(d)(1). The alternative to "as available" deliveries, with prices based on avoided costs calculated at the time of delivery, is a "legally enforceable obligation," with pricing based on avoided costs calculated at the time the obligation is incurred. 18 CFR § 292.304(d)(2). While Staff's proposed quarterly determination of market prices might be closer in time to the "as available" deliveries than PacifiCorp's biennially-determined Schedule 37 prices, they would still not be "calculated at the time of delivery." Given the context, where the alternative to costs "at the time of delivery" would be costs determined for a "legally enforceable obligation" as many as 20 years prior to delivery, it is reasonable to allow the use of Schedule 37 prices.

7. **No payment should be required for energy deliveries by off-system QFs in excess of the QF's net output. [Issues 3.b and 14]**

Staff proposes that "For off-system QF contracts, energy deliveries in excess of the QF's net output that are not offset during the settlement period should be valued at the non-firm off-peak spot price." Staff Brief Attachment A, Item 26. In its Opening Brief (p. 22, fn 12), PacifiCorp noted that the net output is the maximum amount of energy that PURPA requires utilities to purchase, and referred to Mr. Griswold's testimony which

[5] There is nothing in the record on which to determine which market hub, or combination of hubs, would be appropriate for PacifiCorp to use for determining "current market prices."



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explained that providing payment for energy in excess of net output would eliminate the incentive for the QF to accurately schedule its output across the settlement period (as recognized by Staff), and could even provide an incentive to over-schedule to the detriment of PacifiCorp's customers. In its Opening Brief (p. 20), Staff clarifies its recommendation that off-system QFs be compensated for excess deliveries at a non-firm off-peak *spot* price. While PacifiCorp's prior arguments still apply, the additional defect with Staff's proposal is that the settlement period over which any excess deliveries would occur will be no shorter than one month, and there is no *monthly* spot price. Staff's recommendation should not be adopted.

**8. Default Security. [Issue 2]**

Staff proposes that the same standards it recommended for small QF standard contracts be applied to large QFs, expressing its belief that its proposal is acceptable, or not objectionable, to the parties. Staff Brief at 16. However, as set forth in its testimony (PPL/304, Wessling/1-2) and Opening Brief, PacifiCorp does oppose applying the small QF standard contract default provisions to large QFs. In addition to what PacifiCorp has already argued, "The standard contract is specifically designed for small QFs, not large QFs." Staff Brief at 13. Further, just as termination provisions in negotiated contracts should be consistent with standard industry practice (Weyerhaeuser-ICNU Brief at 19), credit and security provisions for large QFs should be consistent with standard industry practice. The standard contracts available to small QFs should not be turned into standard contracts for large QFs that the Commission has already determined are to be negotiated contracts.

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1 **9. Competitive bidding should be used to set prices for QFs 100 MW and larger with contract terms of at least five years. [Issue 11]**
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3 The Staff and Weyerhaeuser-ICNU argue that limiting payments to energy only when
4 a proposed QF that is 100 MW or larger either fails to participate or is unsuccessful in the
5 RFP process may violate PURPA because by only paying for energy over the course of a 20-
6 year contract the Company's avoided costs in future deficiency periods will not be
7 considered. This argument, however, misses the point of requiring a competitive bidding
8 process. Using competitive bidding as the method to determine avoided costs is perfectly
9 appropriate under PURPA and has been sanctioned by FERC. As it stated in *Re Southern*
10 *California Edison Co.*, 70 FERC ¶ 61215, 61677-78, 1995 WL 169000, *16-17 (F.E.R.C.
11 Feb. 23, 1995), "[m]any . . . states . . . use some sort of bidding procedure to establish
12 avoided cost."
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> [T]he Commission gives great latitude to state commissions as to procedures selected to determine avoided costs. . . . [U]nder PURPA an avoided cost (incremental cost) determination must permit QFs to participate in a non-discriminatory fashion and, at the same time, assure that the purchasing utility pays no more than the cost it otherwise would incur to generate the capacity (or energy) itself "or purchase from another source" (the language of section 210 of PURPA, emphasis added). Congress in this language did not in any way limit the sources to be considered. The consequence is that regardless of whether the State regulatory authority determines avoided cost administratively, through competitive solicitation (bidding), or some combination thereof, it must in its process reflect prices available from all sources able to sell to the utility whose avoided cost is being determined.[6]

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[6] *See also, e.g., Proposed Regulations, Regulations Governing Bidding Programs*, 53 Fed. Reg. 9324 (1988), FERC Statutes and Regulations ¶ 32,455 (1988) (proposed rulemaking to establish competitive bidding for determining avoided costs: "The purpose of bidding is to determine which suppliers will receive avoided capacity payments. . . . Under the Commission's proposal, bidders would compete for the opportunity to supply capacity and energy to the purchasing utility. Utilities would still be required to purchase electric energy from QFs that submitted losing bids or decided not to participate in bidding. However, payment to these QFs would be based only on avoided energy costs. QFs that were unsuccessful bidders or did not participate in the bidding process would not be entitled

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1 Such language sanctions this Commission's authority to rely solely on a competitive
2 bidding process to establish the Company's avoided costs. What the Staff and
3 Weyerhaeuser-ICNU argument would require is that the Commission implement only an
4 administrative method to establish avoided costs for future capacity payments when, many
5 years down the road, the Company anticipates a resource deficiency. In other words,
6
7 Weyerhaeuser-ICNU wants to avoid the competitive bidding process and receive an
8 administratively determined capacity payment even though the competitive bidding process
9 will be the best indicator of costs. This would potentially result in overpayment for future
10 capacity (given the uncertainties of an administrative determination on avoided costs 10 to 20
11 years in the future) and would undermine the efficacy of the Company's proposal that QFs
12 100 MW or larger be required to participate in the competitive bidding process to obtain
13
14 capacity payments. It is essentially an argument that the Commission cannot rely solely on a
15 competitive bidding process to determine avoided costs, an argument that is inconsistent with
16 the FERC precedent cited above and that has been rejected previously.[7] The Commission
17 should reject the argument.
18

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19 to avoided capacity payments."). This proposed rulemaking was later terminated due to
20 being overtaken by later events such as the passage of the Energy Policy Act of 1992. In the course of terminating the rulemaking, however, FERC noted that "Now 30 states use
21 competitive bidding . . . . Thus, both state regulatory commissions and utilities appear to be making substantial progress without the need for additional Commission guidance." *See*
22 *Order Terminating Proceedings, Regulations Governing Bidding Programs*, 64 FERC ¶ 61,364 (F.E.R.C. Sept. 29, 1993).

23 [7] *See, e.g., Phoenix Power Partners, L.P. v. Colorado Public Utilities Comm'n*, 952 P.2d 359, 367 (Colo. 1998) (Court rejected appellant's arguments that state commission was
24 required to address future needs by determining avoided costs outside the scope of the bidding process: "In the case that is before us, the PUC found that if Phoenix wished to sell
25 its QF energy and capacity under the new 1993 Agreement, it must submit its contract into the bidding process just like any other potential developer. The PUC found that 'the
26 effective procedure for determination of Public Service's avoided costs' under the Phoenix contract was the bidding process. Further, the PUC concluded that 'PURPA, the FERC QF

**10. The record supports allowing consideration of the effects of debt imputation in determining negotiated avoided cost payments. [Issue 13]**

In its argument that there is inadequate support for considering the effects of debt imputation, Weyerhaeuser-ICNU makes statements that are simply not correct. First, Weyerhaeuser-ICNU asserts that "PacifiCorp could not provide a specific methodology that it would use to adjust for debt imputation."[8] Weyerhaeuser-ICNU Brief at 26. Contrary to that assertion, PacifiCorp provided a thorough description of its proposed methodology in its direct testimony. PPL/800, Shah/5, 9-10; PPL/801; PPL/806. Weyerhaeuser-ICNU also claims that there is no legitimate basis to treat large QFs differently than small QFs. Weyerhaeuser-ICNU Brief at 26. That assertion is contrary to the FERC regulations differentiating small (100 kW or less) QFs from larger QFs,[9] and also contrary to the Commission's determination in Order No. 05-584 to treat small QFs differently than large QFs, with one of the reasons for doing so being that "the risk customers face because avoided costs in the future may be different from the prices paid under a standard contract . . . is greater for a large QF than a small one." Order No. 05-584 at 16.

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Rules, and the [Colorado QF Rules] do not compel Public Service to purchase all capacity and energy offered to it by [Phoenix]' nor do they require the PUC to set a 1993 avoided cost purchase price for Phoenix outside the established bidding process. We agree with the district court that this conclusion by the PUC is just and reasonable.").

[8] In support of its statement, Weyerhaeuser-ICNU cites ICNU/308, Beach/8, which is a data request response explaining that PacifiCorp would not adjust large QF's avoided costs for debt imputation, but would instead make a line-item adjustment to the QF's monthly payment. The methodology for determining the amount of that adjustment had already been explained in PacifiCorp's direct testimony.

[9] 18 CFR § 292.304(c).



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## CONCLUSION

PacifiCorp respectfully requests that the Commission issue an order adopting PacifiCorp's positions as set forth herein, and in its Opening Brief and testimony (except as modified herein).

DATED: July 12, 2006.

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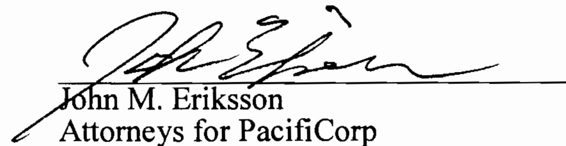

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