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Re: UM 1129

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

Very truly yours,

John M. Eriksson

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BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1129

In the Matter of

PUBLIC UTILITY COMMISSION OF OREGON

Staff's Investigation Relating to Electric Utility Purchases from Qualifying Facilities

PACIFICORP'S OPENING BRIEF ON PHASE II ISSUES

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PacifiCorp (or the "Company") hereby submits its opening brief regarding the Phase II issues specified in the ALJ's March 3, 2006 Ruling.

INTRODUCTION

Most of the issues being addressed at this point in this case are related to QFs with a nameplate capacity over 10 MW (referred to as "large QFs"), while some issues, such as the use of a Mechanical Availability Guarantee, relate also to QFs with a nameplate capacity up to 10 MW ("small QFs"). Where appropriate, PacifiCorp identifies the issues that pertain also to small QFs.

The Commission's resolution of the issues remaining in this case must again be based on a proper balancing of the PURPA objectives, and the Commission's goal, to "encourage the economically efficient development of [ ] qualifying facilities ("QFs"), while protecting the ratepayers by ensuring that utilities pay rates equal to that which they would have incurred in lieu of purchasing QF power." Order No. 05-584, issued in this Docket on May 13, 2005, p. 1. In addition, as will be discussed below, the Commission also should consider certain aspects of the Energy Policy Act of 2005 in making its determinations. The evidentiary record, coupled with those policies, will provide the Commission with a sound basis for bringing this case to a reasonable and final conclusion.

DISCUSSION

A. Contract Terms and Pricing for Large QFs Should be Based on the Particular Project's Characteristics and its Impacts on the Purchasing Utility's System. [Issues 1 and 3.a]

1. Whether deliveries are made as firm deliveries under legally enforceable obligations, or are made on a non-firm, as available basis, impacts default provisions of a PPA.

Issues 1.b, 1.c and 3.a address how power supply commitments and pricing should be affected by whether the QF's deliveries are made pursuant to "legally enforceable obligations" versus "as available," and whether they are "firm" versus "non-firm." There appears to be general agreement that "firm" deliveries equate with "legally enforceable obligations" under which the QF commits to deliver specific quantities of power, while "non-firm" deliveries equate with deliveries that are made on an "as available" basis. *See* PPL/404, Griswold/3-4; Staff/1800, Schwartz, 6; Weyerhaueser-ICNU/300, Beach/22.

Deliveries made on a non-firm or "as available" basis impact the existence of damages for under-delivery or non-delivery, and accordingly, the utility's need for default security. Consistent with the lack of obligation on the part of the QF to deliver any certain amount of power on a non-firm or as available basis, there is not a need to provide for default damages for construction delay or under-delivery, and likewise, no need to provide for credit requirements or default security. PPL/303, Wessling/1-2; Staff/1800, Schwartz/6-7.

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2. Pricing for firm deliveries should not be the same as pricing for non-firm deliveries.

The prices paid to QFs for delivery of electricity should reflect the avoided cost attributable to the type of product being delivered. A QF that makes firm deliveries pursuant to a legally enforceable obligation should receive prices that reflect the firm nature of the resource, which the utility can rely on for planning purposes. Parties do not dispute that such firm deliveries should be priced to include the avoided cost of capacity. Consistent with a prior determination by the Commission, non-firm, as available deliveries, which by definition cannot be relied upon, should not receive payment for capacity, but should receive an off-peak (energy only) rate, i.e., the off-peak price in PacifiCorp's Schedule 37. PPL/404, Griswold/3; Staff/ 2401, Chriss/1.

Staff takes exception to PacifiCorp's proposal and argues that non-firm deliveries should receive "market-based pricing." Staff/1800, Schwartz/6; Staff/2400, Chriss/4. Without explaining why market-based pricing is appropriate for non-firm deliveries, other than its asserted alignment with the PURPA regulation that the avoided costs be calculated at the time of delivery,[1] Staff argues that a market-based rate is appropriate for payment for non-firm or "as available" deliveries. Staff/2400, Chriss/4.

Staff's proposal would require PacifiCorp to inappropriately overpay non-firm QFs by paying for capacity that cannot be relied upon. In Order 05-584, the Commission recognized the inappropriateness of paying capacity costs for deliveries that cannot be relied

[1] Staff/1900, Chriss/2, citing 18 CFR § 292.304(d)(1). Staff finds a quarterly projection of market prices as satisfying the "at the time of delivery," but apparently believes that the biennial projection contained in PacifiCorp's Schedule 37 is not close enough in time, at least to some of the deliveries that would be priced under that Schedule, to meet the "at the time of delivery" criterion. Staff/2400, Chriss/4.

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upon. With regard to deliveries in excess of a facility's nameplate capacity, the Commission found, "As electric utilities cannot expect and, therefore, would not rely on deliveries of excess energy in any manner, we conclude that energy delivered in excess of the nameplate rating does not provide capacity benefits that warrant payment of full avoided costs," and that for excess energy deliveries, the utilities should pay QFs for "only the energy itself and not capacity." Order No. 05-584 at 28. For purposes of determining what should be paid for non-firm energy, non-firm energy has the very same relevant attribute as excess energy: "A non-firm QF resource can deliver in any hour, or not, which the utility cannot plan for in any way." PPL/407, Griswold/13. Nevertheless, Staff acknowledges that the market-based prices will include some capacity payments (Staff/2400, Chriss/5), yet at the same time, with respect to payment for excess energy, recognizes that the QF appropriately only "receives the off-peak (energy only) rate." Staff/2300, Schwartz/2. Staff's position that QFs should be paid market-based prices for non-firm deliveries cannot be reconciled with the Commission's conclusion that payments for excess energy should not include any compensation for capacity because such energy cannot be relied upon by the utility.

Likewise, Weyerhaeuser-ICNU's proposal that utilities should pay prices that include capacity costs for any "as available" or non-firm deliveries that happen to occur during on-peak periods suffers the same flaw. Weyerhaeuser-ICNU/300, Beach/5, 13, 22.[2] A QF making such deliveries has no obligation to deliver a minimum amount of power during on-peak hours, or any hours, and consistent with the Commission's determination regarding excess energy, must not receive anything more than an energy-only (off-peak) price.

[2] In his testimony, Mr. Beach asserts that "as-available" or "non-firm" QFs should receive capacity payments for delivery during on-peak periods, without distinguishing between "as-available" and "non-firm."

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Because PacifiCorp schedules its resources on a day-ahead basis, any non-firm delivery that comes in after that schedule is set would more appropriately be priced at the Company's decremental cost of energy—certainly not including any capacity cost. PPL/407, Griswold/13-14. Weyerhaeuser-ICNU's proposal to pay QFs for capacity when they make "as available" or non-firm deliveries during on-peak periods would provide payments in excess of the utility's avoided costs and must be rejected.

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

The FERC regulations implementing PURPA specify a number of factors that shall, to the extent practicable, be taken into account. Nothing in those regulations suggests that the list of factors is to be what Staff summarily concludes to be an "all-exclusive list." Staff/1800, Schwartz/15-16. The overarching requirement that utilities pay QFs avoided costs, and not more, must not be lost in an exercise of form over substance, where parties disregard proven costs or benefits to the utility simply because they are not on a pre-approved list of possible adjustment factors. Yet, that is exactly what Staff and Weyerhaeuser-ICNU are proposing. *Id;* Weyerhaeuser-ICNU/300, Beach/24.

Weyerhaeuser-ICNU puts forth the unfounded argument that if utilities are allowed to modify the standard rates in ways regarding which the Commission has not previously given direction, they will have "*carte blanche*" to modify avoided cost rates in ways the Commission has not previously reviewed. *Id.* Weyerhaeuser-ICNU seems to forget that the utilities' conduct is subject to Commission scrutiny. PacifiCorp is fully aware that it will need to act reasonably and in good faith in its dealings with QFs. PPL/407, Griswold/12. Accordingly, the Company would not have the *carte blanche* suggested by Weyerhaeuser-

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ICNU, and there is no need to create an "all-inclusive" list of factors that can be taken into account when negotiating avoided cost rates. Adoption of such a bright-line position would exacerbate the risk of departing from the ultimate objective of determining the costs actually avoided.

4. PacifiCorp's proposed methodology for line loss adjustments is reasonable.

Adjustment of avoided cost prices, either as an increase or a decrease, is based on costs or savings resulting from a QF delivering power to a load area in lieu of power that the utility would have supplied to that same area (either generated or purchased). PacifiCorp's proposed methodology for determining line loss adjustments is a proximity-based approach which is standard in the industry and is applied on a case-by-case basis, and is fully described in the Company's testimony. PPL/407, Griswold/2-6. Adjustments under the proposed method, whether positive or negative, are based on the proximity of the proposed QF relative to the load area, as compared to the proxy resource relative to the load area. Line loss adjustments would not be made for QFs with unpredictable output, such as wind projects, since, due to the unpredictable nature of the resource, it cannot be known if line losses will be incurred, or avoided. Further, loss percentage factors contained in the Company's published Open Access Transmission Tariff ("OATT") would be utilized in calculating any line loss adjustments.

Weyerhaeuser-ICNU's criticism of the Company's proposed method for addressing line losses seems to be based on a misunderstanding, and is off point. Contrary to the first criticism, the approach is not "one-sided," (Weyerhaeuser-ICNU/304, Beach/8-9) but is explicitly intended to capture either additional costs or savings. PPL/407, Griswold/2, 3, 6.

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Secondly, the Company's proposed method described in its rebuttal testimony (and in a data request response) does not employ individual transmission studies of which Weyerhaeuser-ICNU is critical. Weyerhaeuser-ICNU/304, Beach/9; PPL/407, Griswold/2-3.

The Company's proposed method for addressing line losses, supported by Staff (Staff/2300, Schwartz/11), is reasonable and should be approved.

5. Dispatchability of a QF should not be addressed through time-of-use pricing.

Weyerhaeuser-ICNU proposes that dispatchability be handled "through time-of-use pricing, in recognition that CHP [combined heat and power] facilities may have no ability to allow the utility physically to dispatch their facilities." Weyerhaeuser-ICNU/300, Beach/13. In other words, Weyerhaeuser-ICNU proposes that the utilities pay the QFs for dispatchability which the QFs cannot provide. While such an approach is understandably desirable from the standpoint of the QF, it does not address dispatchability from the standpoint of the utility's avoided costs. From an avoided cost standpoint, a QF that offers to sell capacity and energy with dispatchability lower than the proxy unit on which avoided cost rates are set, should have a decreased capacity payment. PPL/404, Griswold/6. Similarly, reliability, to the extent a QF's reliability varies from the proxy resource's reliability, should be addressed on a case-by-case basis and should be taken into account in the capacity payment to the QF. PPL/407, Griswold/14-15.

Staff also opposes the use of time-differentiated pricing for addressing dispatchability, and instead proposes the use of stochastic modeling. Staff/2300, Schwartz/8-10. The IRP-type stochastic modeling proposed by Staff to address dispatchability would be

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unnecessarily burdensome and time consuming (at a time when QFs desire timely turnaround on indicative price proposals), and should not be required.

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

Integration costs are those costs imposed on a utility to accommodate the variable generating output of intermittent resources such as wind. PPL/404, Griswold/13; Staff/1800, Schwartz/22. PacifiCorp and Staff agree that avoided cost prices should be adjusted to account for the cost of integrating intermittent resources into the utility's system. PacifiCorp and Staff also agree that the utility's most recent IRP should serve as the foundation of the determination of integration costs, and that the determination of integration costs should also be consistent with the utility's treatment of competitively bid resources.[3] PPL/407, Griswold/7; Staff/1800, Schwartz/ 23-24. However, PacifiCorp and Staff propose different approaches for determining those costs, with one difference being the Company basing its determination in light of a long-range view, while Staff proposes to base the determination on only the cost of integration into the existing system of the utility. Staff/1800, Schwartz/22. Although, from a conceptual standpoint, PacifiCorp is not opposed to Staff's proposed approach to determining integration costs, it does not believe the preciseness sought to be gained warrants the significant time commitment and expense that would be incurred in performing individual IRP modeling analyses for each proposed intermittent QF project over 10 MW. PPL/407, Griswold/7.

[3] PacifiCorp's proposal based on its current updated IRP estimates the cost of integration to be $4.64/MWh, escalating over time as more wind resources are added. PPL/404, Griswold/14.

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7. PacifiCorp's Schedule 38 sets forth a reasonable process for the negotiation of PPAs for large QF projects. [Issue 1.e]

PacifiCorp's Schedule 38, filed with its compliance filing in this case on July 12, 2005, provides a "roadmap" for the Company and a large QF developer, specifying the steps and a schedule for the Company and the developer to follow for the negotiation of a PPA. Schedule 38 provides the step-by-step process that will enable the Company to develop indicative avoided cost prices, a draft PPA, and ultimately, a negotiated PPA suitable for execution. Schedule 38 is based on a tariff schedule that was developed for use in Utah, which has been successfully used to lead to the completion of several QF projects. PPL/404, Griswold/9-10.

Staff finds Schedule 38 to be generally reasonable, subject to several suggestions. Staff/1800, Schwartz/20-21. First, Staff correctly notes that since the gas indexing options available for small QF projects are being considered in this phase of the case for applicability to large QFs, it is premature to refer to those options in the Schedule, and the references should accordingly be deleted. Second, Staff recommends flexibility in the timing of the required interconnection study, which the Company does not oppose, provided the QF is diligently pursuing completion of the study. Third, Staff recommends specifying additional timelines, as it did with regard to Schedule 37, which the Company does not oppose, with the understanding that flexibility will be required to the extent comments or proposals are made which reflect significant departures from proposed terms and require additional time for analysis. The Company is committed, and required by the Schedule (Section 6.a) to not unreasonably delay negotiations and to respond in good faith.

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Weyerhaeuser-ICNU asserts that the Commission has "made clear that negotiations with large QFs should start from the standard contract." Weyerhaeuser-ICNU/300, Beach/23. However, as reflected in the provisions of Order No. 05-584 upon which Weyerhaeuser-ICNU relies, it is the standard *avoided costs* that are to serve as the starting point for negotiated avoided cost prices, not the standard contract terms. PPL/407, Griswold/12. As stated by Staff, "The standard contract is specifically designed for small QFs, not large QFs." Staff/2300, Schwartz/13. Working from the erroneous premise that the standard contract for small QFs is supposed to be the starting point for negotiations for large QF PPAs, Weyerhaeuser-ICNU proposes that utilities be required, when they send a draft PPA to a large QF, to explain in writing how and why the terms of the draft differ from the standard contract. Weyerhaeuser-ICNU/300, Beach 24. The utilities should not be required to make such comparisons and explanations. Staff/2300, Schwartz/13.

Weyerhaeuser-ICNU also argues that the utilities should not be allowed to draft negotiated contracts in ways in which the Commission has not provided guidance in this proceeding. Weyerhaeuser-ICNU/300, Beach/24. Weyerhaeuser-ICNU's position is based on its concern that, otherwise, the utilities will have "unlimited flexibility to negotiate each and every term of the contract." *Id.* Weyerhaeuser-ICNU's concern is unfounded because, as with negotiated avoided cost prices, the utilities' conduct is subject to Commission scrutiny, and PacifiCorp is fully aware that it will need to act reasonably and in good faith in its dealings with QFs. PPL/407, Griswold/12. Further, Weyerhaeuser-ICNU's proposal incorrectly assumes that the Commission has considered, and given guidance on, every possible circumstance that might warrant the utility or the QF proposing a contract provision

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that addresses a circumstance in a unique and appropriate manner. The utilities, and the QFs, should have the flexibility necessary to negotiate contract terms that are appropriate under the particular circumstances, and should not be precluded from proposing and agreeing on terms crafted to address those circumstances.

B. Default Security and Damages. [Issues 2 and 6]

Establishing an appropriate level of default security is necessary to protect the utility and its customers from the risk of default by a non-creditworthy counterparty to a PPA, whether that counterparty is a QF or otherwise. In Phase I of this case, the Company proposed to cap the amount of default security that can be required of small QFs at twelve average months of replacement power costs over the term of the contract. For large QFs, the Company proposes to cap the amount of required default security at thirty-six average months of replacement power. PPL/303, Wessling/2. As with the Company's proposal in Phase I, the time period applied to the determination of the default security amount will be based on the amount of time expected to replace the large QF resource with forward market purchases. *Id.* The proposed increase in the cap, recognizing the greater risk imposed by having to replace what may be several hundred megawatts, as opposed to ten megawatts at most, is justified and reasonable.

Further, the senior lien and step-in rights options available to small QFs should not be *required* to be extended to large QFs. Even in the unlikely event a QF could provide a senior lien to the utility, there is no assurance that the lien would provide adequate coverage for the damages caused by the QF's default. The absence of assurance of coverage is likewise true for step-in rights, since the QF may be inoperable or have such high costs that it would be

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uneconomic to operate. PPL/304, Wessling/1-2. While, based on the QF's circumstances, and as part of the negotiation process, the parties might negotiate lien or step-in rights, it would not be reasonable to mandate that the QF be allowed to select such options in all instances of large QF negotiations.

With regard to whether there should be a cap on the amount of default losses that can be recouped by reducing future payments to the defaulting QF, PacifiCorp's position is the same as it was in Phase I: the Commission should not expose the Company and its customers to the risk of the QF's default by imposing such a cap. PPL/303, Wessling/3. See also Staff/2000, Morgan/3 ("Capping default losses could also contribute to the likelihood of a QF abandoning a project. By not capping default losses, we can discourage a QF from abandoning a project and therefore help ensure greater reliability and protect customers from increased costs due to default.") Such a cap would inappropriately shift risk from the defaulting QF to the utility and its customers.

C. The Commission Should Approve the Use of a Mechanical Availability Guarantee for the Establishment of Minimum Delivery Obligations. [Issue 4]

PacifiCorp and Staff propose that a Mechanical Availability Guarantee ("MAG") be used as a performance standard, in place of a minimum delivery obligation, for all intermittent (wind and run-of-river hydro) QF projects, regardless of whether they are small or large. PPL/404, Griswold/15-19; Staff/1800, Schwartz/29. A MAG operates so as to affect the dollar payment to the QF to the extent the QF does not meet its contractual availability commitment; it does not affect the calculation of avoided cost prices. PPL/404, Griswold/15. PacifiCorp's MAG appropriately recognizes that a wind or run-of-river QF cannot accurately forecast generation output months in advance, and measures the QF's

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performance by what it can control—the mechanical availability of its turbines. PPL/407, Griswold/16. The operation of the MAG, and the related contractual provisions that would be necessary, is described in detail in the testimony of Mr. Griswold and Ms. Schwartz. While Staff recommends that the Commission *require* the utilities to include the MAG in firm *standard contracts* for intermittent QFs (Staff/1800, Schwartz/29-30), PacifiCorp proposes that the Commission *allow* the use of a MAG in its standard contracts for small intermittent QFs. For large QFs, the Commission should likewise allow the use of the MAG as an alternative to the use of minimum delivery obligations. Further, consistent with the Commission's prior determination that contracts and prices for large QFs are to be negotiated, the Commission should expressly recognize that the particular levels of availability guarantees under MAGs will be established by contracting parties on a case-by-case basis, taking into account the attendant conditions and characteristics. Accordingly, ODOE's proposed 65% mechanical availability guarantee (ODOE/10, Keto/2) should not be adopted as the required level for all negotiated PPAs with large QFs.

D. The Commission Should Not Expand the Use of Indexed Pricing Options. [Issue 5.a]

Issue 5.a asks whether PacifiCorp should offer a market pricing option. For a number of reasons, PacifiCorp should not be required to offer either gas indexed pricing options to large QFs, or a power market indexed option to either small or large QFs.

First, with regard gas indexed pricing, Weyerhaeuser-ICNU proposes that the Commission require that the same two gas indexed options available to small QFs pursuant to Order No. 05-584 be made available to large QFs. Weyerhaeuser-ICNU/300, Beach/24-26. That proposal is opposed by Staff, PacifiCorp, PGE and Idaho Power. Staff/1900,

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Chriss/7, Staff/2400, Chriss/2; PPL/407, Griswold/8-10; PGE/500, Kuns-Sims/7; Idaho Power/300, Gale/5. Weyerhaeuser-ICNU's proposal would expose PacifiCorp to significant risk due the wide fluctuations in the gas market. PacifiCorp does not presently have a mechanism that would allow it to flow through to customers the increases, and decreases, that occur in the natural gas market, and it would be unreasonable to impose the risk of cost fluctuations on utility shareholders when that risk would be caused by purchases from QFs that the utility is required to make for customers.[4] PPL/407, Griswold/8. Such imposition of risk on shareholders would be contrary to the Energy Policy Act of 2005, requiring that FERC enforce regulations ensuring that a utility recovers all costs prudently incurred in purchasing energy or capacity from a QF pursuant to a legally enforceable obligation.[5]

The imposition on PacifiCorp of gas indexed pricing options for large QFs must be rejected for a more fundamental reason—it would be contrary to the PURPA ratepayer neutrality standard, *i.e.*, it would require payments to QFs in excess of the Company's avoided costs. Specifically, the proposal either disregards avoided cost, or is based on an erroneous assumption that the utility would be 100% exposed to gas market price fluctuations, but for the purchase from the QF. For PacifiCorp, that is simply not the case. PPL/407, Griswold/9. As Staff recognizes, PacifiCorp employs risk management and hedging programs to manage gas price risk. Staff/1900, Chriss/9. Making payments to QFs that are based on indexed gas prices would disregard the reality of PacifiCorp's risk

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[4] Even if such a mechanism were in place, for QFs with a thermal host utilizing natural gas as part of its industrial process, Weyerhaeuser-ICNU's proposal would inappropriately pass on to the utility and its customers the gas volatility risk associated with that process, in addition to the risk associated with the production of electricity. Idaho Power/400, Gale-Allphin/12-13.

[5] 16 U.S.C. § 824a-3(m)(7). Section 210(m) was added to PURPA by section 1253(a) of EPAct 2005.

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management and hedge programs that limit exposure to price fluctuations for periods that are hedged. PPL/407, Griswold/9. That is, the gas costs that PacifiCorp would incur with the avoided resource would not reflect the totally exposed gas price risk for which Weyerhaeuser-ICNU wants to be paid. Weyerhaeuser-ICNU's proposal is contrary to PURPA and must be rejected.

With regard to a power market indexed option, Staff proposes that PacifiCorp offer such a pricing option on the basis that it would provide parity with PGE, which has such an option. Staff/1900, Chriss/5. "Parity with PGE" cannot be seen as a reasonable basis for requiring PacifiCorp to offer a market based pricing option, because parity with *Idaho Power*, which does not have such a pricing option, would equally dictate that PacifiCorp should *not* offer the option. PPL/407, Griswold/10-11. As to why the Commission should not require PacifiCorp to offer a market price indexing option, PacifiCorp points to the excessive cost exposure to the utility and its customers that would occur because of fluctuations in the market price, which would not be recovered in rates under the regulatory mechanisms currently in place. PPL/407, Griswold/10. On this point, Staff witness Steve Chriss notes that the Company already offers options tied to monthly natural gas index prices, and that he is unaware of what "the incremental risks are of adding another option based on the power market, which are also inherently volatile." Staff/2400, Chriss/8. Simply stated, the incremental risk is just that—incremental to the risk already borne, and if required to be available to large QFs, could be more than an order of magnitude higher than would exist for the gas market index options that are required to be offered to small QFs. It would

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not be reasonable to expose the Company to such cost underrecovery risk simply to provide parity with PGE.

As with the proposal to require gas index pricing for large QFs, the power market indexing would also be contrary to the ratepayer neutrality standard in that it disregards the risk management and hedging activity utilized to mitigate the risk of market price fluctuations.

Further, there is not an adequate record for the Commission to require a particular power market index option. In its direct testimony, Staff had no recommendation, pending review of PacifiCorp's testimony, for what hub or combination of hubs should be used, nor did it have a recommendation on whether to use daily or monthly prices. Staff/1900, Chriss/5.

For all the foregoing reasons, the Commission should not require PacifiCorp to offer gas indexed options to large QFs, nor should it require that PacifiCorp offer a power market indexed option to either small or large QFs.

E. Dispute Resolution. [Issue 10]

PacifiCorp continues to concur with Staff on the role of Staff and the Commission with regard to dispute resolution. Staff/1800, Schwartz/35-36.

F. Competitive Bidding Should be Used to Set Prices for QFs 100 MW and Larger With Contract Terms of at Least Five Years. [Issue 11]

PacifiCorp proposes that the terms, conditions and price for capacity purchases from QFs that are 100 MW or larger, and with contract terms of at least five years, be determined through an all source competitive bidding process. PPL/404, Griswold/24-26. In order for the QF to be eligible for a specific capacity payment, the QF would be required to submit a

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winning proposal in that competitive bidding process. However, offers of QF capacity made outside of the bidding process, or by QFs that are not selected through the competitive bidding process, would not receive capacity payments, at least during the period of resource sufficiency. Such QFs would however receive payment for energy. *Id.*

The use of a competitive bidding approach for setting avoided cost prices for very large long-term QF projects would provide the Commission, customers, utilities, and QF developers with the best available determination of the utility's avoided costs. Further, failure to require such QFs to obtain specific capacity payments through a bidding process would tend to diminish the effectiveness of the process. Allowing such large QFs the option of either RFP-based or administratively-determined avoided cost prices may result in inflated RFP bid prices, because such QFs could always bid above the administratively-determined avoided costs, knowing they would always have the fall-back option of contracting at those prices if they are not successful in the RFP. *Id.*

While Staff does not object to the use of competitive bidding for calculating avoided costs for QFs 100 MW and larger, it takes exception to the Company's statements that it would not pay a QF for capacity if that QF was not the successful bidder in the RFP. Staff/2300, Schwartz/20. However, if the RFP process satisfies the need for capacity, additional capacity then brought to the utility by an unsuccessful QF (or any other producer) will not have the value that capacity would have during the period of resource deficiency.

The use of competitive bidding for determining avoided costs would provide the best measure of a utility's avoided costs, and accordingly, the Commission should approve its use.

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G. Energy Policy Act of 2005.

PacifiCorp concurs with Staff's comments regarding the implications of the Energy Policy Act of 2005 ("EPAct 2005"). Staff/1800, Schwartz/37-38. In addition, there are certain provisions EPAct 2005 that are relevant to the Commission's consideration of issues in this case, such as the direction regarding cost recovery discussed above with regard to indexed pricing options. Another aspect of EPAct 2005 that is relevant to this case from a policy perspective is the vehicle it provides to utilities to be relieved of the "must purchase" requirement of PURPA.[6] That departure from the prior absolute mandate directed at promoting the development of a competitive generation market should be considered by the Commission in balancing the objectives of promoting the development of QFs, while also ensuring ratepayer neutrality.[7]

H. It is Appropriate to Consider the Effects of Debt Imputation in Determining Negotiated Avoided Cost Payments. [Issue 13]

The debt imputation referenced in Issue 13 occurs as a result of utilities entering into PPAs which have certain characteristics resulting in the PPAs being treated as debt of the purchasing utility. The debt imputation issue has come to the forefront in recent years with the issuance of Emerging Issues Task Force ("EITF") 01-8, "Determining Whether an Arrangement Contains a Lease" and Financial Interpretation No. 46R("FIN 46"), "Consolidation of Variable Interest Entities."[8] PPL/700, Stuver/1. EITF 01-8 and FAS 13

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[6] 16 U.S.C. § 824a-3(m). Section 210(m) was added to PURPA by section 1253(a) of EPAct 2005.

[7] In addition to the federal move away from a "must purchase" requirement, the State has also exempted PacifiCorp and PGE from Oregon's statutes and rules requiring purchases from QFs. ORS 757.612(4); OAR 860-029-0001.

[8] In asserting that the potential inclusion of power purchase agreements in a utility's balance sheet is not a "new accounting standard," Staff witness Morgan points to FAS 13, issued in 1976. Staff/2500, Morgan/4. However, EITF 01-8 and FIN 46 are new, and while

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require PacifiCorp to recognize certain PPAs as capital lease obligations, which are considered and treated as debt, resulting in an impact on the Company's credit quality. PPL/800, Shah/1-2. Even if a QF PPA is not treated as a capital lease obligation, it may have similar debt impacts pursuant to FIN 46, or may have similar debt-like impacts under guidelines established by rating agencies. *Id.*

The impact of such debt on the Company is actually quite straightforward, notwithstanding other parties' attempt to characterize the issue as unmanageable. Specifically, the debt related to PPAs reduces the amount of debt the Company might otherwise issue while maintaining a particular debt/equity ratio. Because equity is more expensive than debt, the increase in equity required to offset the impact of the PPA-related debt on the Company's capital structure and to allow PacifiCorp to maintain credit quality and compliance with financing agreements and other commitments, would impose additional cost on the Company and its customers. PPL/800, Shah/4. That additional cost is the difference between the pre-tax cost of equity and the pre-tax weighted average cost of capital, times the amount of equity needed to rebalance the capital structure. PPL/800, Shah/5; PPL/801.

Based mostly on objections of imprecision in adjusting payments to QFs to account for the cost of imputed debt attributable to QF PPAs, Staff opposes the Company's proposal. While recognizing that "there may be an imposition of costs due to the terms of a specific contract," Staff objects to the Company's proposal on the basis that "there is no precise, generic algorithm to adjust for potential costs" and that it would be "difficult" to determine

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S&P hadn't done so in the past, this year it has quantified the impact of existing PPAs on PacifiCorp's credit in reports on the Company. PPL/807, Shah/2. The significance of the issue is certainly new.

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whether an adjustment is warranted. Staff/2500, Morgan/3, 7. Needless to say, if "difficulty" and the lack of a "precise, generic algorithm" were valid reasons for the Commission to throw up its hands and decide that an adjustment should not be made for actual costs or benefits, the number of potential adjustments to the standard avoided cost rates would be considerably reduced, if not eliminated. Staff witness Schwartz appropriately recognizes that adjustments to standard avoided cost rates involves *estimates* and *projections*. *See, e.g.,* Staff/1800, Schwartz/ 9, 11, 22; 24. Indeed, the entire avoided cost determination necessitates the use of estimates, because it is based on future costs that will not actually be incurred. The facts that the estimation of costs associated with imputed debt may be difficult and not based on a single precise, generic algorithm, is not a basis for refusing to allow an adjustment for a cost that actually occurs.

In challenging the need for an adjustment on account of the debt imputation costs, Staff witness Morgan also relies heavily on a paper published by EPSA, a "national trade association representing competitive power suppliers, including generators and marketers," characterizing the report as "objective."[9] Staff/2500, Morgan/5. Rather than being seen as an objective report, the EPSA report should be considered for what it is—an advocacy piece written to support the interests of the entities EPSA represents, non-utility generators and marketers. PPL/900, Avera/14.

Weyerhaeuser-ICNU argues that if the Commission is going to deal with the debt imputation costs, it should do so in some manner other than through an adjustment to prices paid to large QFs. Weyerhaeuser-ICNU seems undecided on how the imputed costs should

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[9] Mr. Morgan quotes extensively from the EPSA report. Staff/2000, Morgan/100-11; Staff/2500, Morgan/6-7, 9-10.

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be recognized, asserting at times that they should be accounted for in the utilities' "filed avoided cost calculations" (presumably referring to the calculation of standard rates),[10] but also asserting that the costs are "best considered in utility general rate case, cost-of-capital proceedings, or other cost recovery cases." Weyerhaeuser-ICNU/304, Beach/12. Accounting for debt imputation costs resulting from certain QF contracts in the calculation of standard avoided cost rates would be inappropriate because, contrary to Mr. Beach's view, such costs are not "the result of the utility's entire portfolio of such contracts."[11] That is, not all QF PPAs will result in either debt being added directly to the Company's balance sheet due to accounting treatment, or credit rating agencies inferring debt. PPL/800, Shah/4. Further, it would be inappropriate to require the utility's customers to pay for the debt imputation costs caused by the QF's PPA, as suggested by Weyerhaeuser-ICNU. Doing so would be akin to having the utility's customers pay the costs of interconnection or integration, which costs are clearly to be paid by the QF, not customers. Staff/1800, Schwartz/22-27; Staff/2300, Schwartz/12; PPL/407, Griswold/7. The appropriate means of recognizing the cost of imputed debt that can result from a QF PPA is to make a PPA-specific determination of that cost and reduce the payments to the QF accordingly. PPL/404,Griswold/27; PPL/900, Avera/17.

I. Stipulated and Undisputed Issues. [Issues 1.a, 3.b, 5.b, 8, 9 and 14]

There are a number of issues that have been resolved by the parties by stipulation or are otherwise undisputed. Issues 1.a, 5.b, 8 and 9 were resolved under the terms of a Partial Stipulation filed with PacifiCorp's rebuttal testimony. PPL/407, Griswold/15-17, PPL/408,

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[10] Weyerhaeuser-ICNU/300, Beach/19; Weyerhaeuser-ICNU/304, Beach/12.
[11] Weyerhaeuser-ICNU/300, Beach/19.

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Griswold/1-12. The specific terms of the resolutions are detailed in Exhibit A to the Partial Stipulation. Generally, the resolutions are as follows: Issue 1.a-- QFs larger than 10 MW should have the unilateral right to select a contract length of up to 20 years for a PURPA contact; Issue 5.b—"Nameplate capacity" should be as defined by BPA, as stated in Staff testimony (Staff/1800, Schwartz/34); Issues 8 and 9—QFs may either contract with the purchasing utility for a "surplus sale" or for a "simultaneous purchase and sale" under specified parameters, and the selection of one arrangement over the other does not in and of itself dictate an adjustment to avoided cost calculations. The resolutions reflected in the Partial Stipulation, which was not opposed by any party, are reasonable and should be approved by the Commission. PPL/407, Griswold/16-17.

In addition to the Issues resolved in the Partial Stipulation, PacifiCorp filed a revised off-system PPA with testimony on March 24, 2006, which reflected the resolution of issues Sherman County/Simplot had with regard to the off-system aspects of the off-system PPA PacifiCorp had initially proposed. PPL/406. Sherman County/Simplot, the party which expressed the most interest in the off-system PPA, found the revised PPA acceptable as to the off-system provisions. Staff, the only other party submitting testimony regarding PacifiCorp's revised off-system PPA, found the various provisions addressing the off-system aspects of the purchase transaction to be appropriate.[12] The revised agreement, which

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[12] With regard to the balancing provisions in the PPA, which provide, among other things, that the Company will pay for the lesser of delivered energy or actual net output, Staff recognized that, "If actual energy deliveries exceed net output during the Settlement Period, the utility should only be required to pay for the QF's net output—the maximum amount of energy that PURPA requires the utilities to purchase." Staff/2200, Brown/5-6. Nevertheless, Staff recommended that the Company "consider modifying its agreement by adding a provision that states that the company will pay QFs the off-peak price for energy delivered in excess of actual net output in the settlement period." Staff/2200, Brown/6. In response, the

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resolves Issues 3.b and 14, is a reasonable standard form for use with small QFs that fit the off-system configuration described in the PPA. PPL/405, Griswold/2.

CONCLUSION

PacifiCorp's positions on the issues presently being addressed in this case are reasonable and reflect an appropriate balancing of the PURPA objectives of the development of QFs, while ensuring ratepayer neutrality. PacifiCorp respectfully requests that the Commission issue an order adopting PacifiCorp's positions as set forth herein and in its testimony filed in Phase II of this case.

DATED: June 7, 2006.

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Company considered the suggested addition, but declined to add such a provision, explaining in rebuttal testimony why such a provision would be inappropriate. PPL/409, Griswold/1-4.

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CERTIFICATE OF SERVICE

I hereby certify that I served a copy of the foregoing document upon the parties of record in this proceeding by electronic mail where available and by first-class mail, addressed to said parties/attorneys' addresses as shown below:

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