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June 7, 2006

Via Electronic and U.S. Mail

Public Utility Commission
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Re: In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Staff's Investigation Related to Electric Utility Purchases from Qualifying Facilities.
Docket No. UM 1129

Dear Filing Center:

Enclosed please find an original and six copies of the Opening Brief on behalf of Weyerhaeuser and the Industrial Customers of Northwest Utilities in the above-captioned docket.

Please return one file-stamped copy of the document in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Anna E. Studenny
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Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the Opening Brief on behalf of Weyerhaeuser and the Industrial Customers of Northwest Utilities upon the parties, shown below, on the official service list by causing the foregoing document to be deposited, postage-prepaid, in the U.S. Mail, or by service via electronic mail to those parties who waived paper service.

DATED at Portland, Oregon, this 7th day of June, 2006.

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1129

In the Matter of the PUBLIC UTILITY COMMISSION OF OREGON Staff's Investigation Related to Electric Utility Purchases from Qualifying Facilities.	))))))))	**INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND WEYERHAEUSER'S PHASE II TRACK II OPENING BRIEF**

OPENING BRIEF OF

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND WEYERHAEUSER

June 7, 2006

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I. INTRODUCTION

Pursuant to OAR § 860-014-0090 and the Administrative Law Judge ("ALJ") Kirkpatrick's May 4, 2006 Memorandum, the Industrial Customers of Northwest Utilities ("ICNU") and Weyerhaeuser Company ("Weyerhaeuser") submit this Opening Brief addressing the issues in Track II of Phase II of this proceeding. Weyerhaeuser and ICNU recommend that the Oregon Public Utility Commission ("OPUC" or the "Commission") adopt reasonable negotiating parameters and guidelines that will accurately value the avoided costs offered to large Qualifying Facilities ("QFs") and reduce the ability of Oregon's investor-owned utilities ("IOUs") to avoid entering into contracts with cost-effective QFs. The Commission also should require PacifiCorp to offer a market index option, ensure that large QFs have the same pricing options as those available to QFs under 10 megawatts ("MW"), prevent the IOUs from requiring QFs to participate in competitive bidding or utilizing competitive bidding to reduce the avoided costs offered to large QFs, and adopt the stipulation regarding the contract term for large QFs and simultaneous purchase/sale contracts.

The Commission's obligation in this proceeding is to develop appropriate requirements for the successful implementation of the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Despite the best efforts of many U.S. utilities, PURPA has not been repealed and still mandates that utilities purchase electric energy and capacity at their avoided costs from QFs. Although Congress passed PURPA to encourage the development of cost-effective non-utility resources, the three Oregon IOUs have

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circumvented PURPA's intent by erecting barriers and entering into few Oregon QF contracts. The utilities historically have been reluctant to purchase electricity from QFs because of the financial loss from reduced sales and the loss of equity returns on investments in utility resources. Regardless of the avoided cost prices approved by the Commission or the cost-effectiveness of the QF, the Oregon IOUs have utilized their superior bargaining positions in the negotiating process to impose barriers and stonewall QF projects.

The Commission's decision in this proceeding will determine whether cost-effective QFs over 10 MWs have any realistic opportunity to enter into contracts with the Oregon IOUs. Adopting reasonable guidelines and negotiating parameters may remove some of the barriers and could allow cost-effective Oregon QFs to enter into contracts with the utilities at reasonable prices that benefit both ratepayers and the electric power system. In addition, successful PURPA implementation can foster the development of lower cost cogeneration and renewable resources than might be developed if the IOUs are required to purchase or build renewable resources pursuant to a mandated renewable portfolio standard.

The Commission has already recognized that QFs larger than 10 MWs face market barriers "that impede negotiation of a viable QF power purchase contract with electric utilities." <u>Re Staff's Investigation Relating to Elec. Util. Purchases from QFs</u>, OPUC Docket No. UM 1129, Order No. 05-584 at 17 (May 13, 2005) ("Order No. 05-584"). Instead of increasing the size threshold to more than 10 MWs for standard contracts, the Commission decided to overcome these market barriers for large QFs "by improved negotiation parameters and guidelines and greater transparency in the negotiation process." Id. ICNU and Weyerhaeuser support the Commission's efforts because increased transparency and the adoption of appropriate guidelines and negotiating parameters could remove a significant obstacle facing cost-effective QF development in Oregon. Weyerhaeuser-ICNU/304, Beach/3.

In this proceeding, ICNU and Weyerhaeuser have sought to adopt the reasonable proposals of Staff and the utilities, and enter into, or not oppose, settlements on certain issues. This Opening Brief identifies areas of agreement with other parties, but focuses on those remaining disputed issues that are likely to be significant barriers to the development of cost-effective QFs. QFs over 10 MWs will not be able to enter into contracts in Oregon if the IOUs have too much discretion or if the methodology to adjust the utilities' avoided costs is unfair, inaccurate, or highly capable of being manipulated. Significant progress has been made in this proceeding, and the Commission has an opportunity to adopt guidelines that potentially will allow utilities and large QFs to successfully negotiate fair contracts that benefit ratepayers and the electric system.

II. BACKGROUND

On January 20, 2004, the Commission opened an investigation related to utility purchases from QFs in order to examine issues that have contributed to the lack of QF development in Oregon. In May 2005, the Commission issued Order No. 05-584 that adopted terms, conditions, pricing and eligibility for standard contracts, ruled that the Commission would not pre-approve utility-QF contracts, and deferred certain unresolved issues to Phase II. The purpose of Phase II was to develop negotiation parameters and

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guidelines for non-standard QFs and simultaneous buy/sell QFs, consider additional market pricing options, and further explore the nature and quality of QF energy, the definition of nameplate capacity, and the role of Staff in the informal dispute resolution process. Order No. 05-584 at 3-4.

On March 3, 2006, ALJ Kirkpatrick issued a ruling adopting a schedule and issues list for this part of the proceeding. <u>Re Staff's Investigation Relating to Elec. Util. Purchases from QFs</u>, OPUC Docket No. UM 1129, Ruling (Mar. 3, 2006). Including subparts, the issues list has twenty-five specific issues. Nearly ten of these issues have been resolved through settlements between the parties. The parties have entered into a partial settlement which has resolved their disputes regarding the contract length available for large QFs, the definition for "nameplate" capacity, and the negotiation parameters and guidelines for "simultaneous sale and purchase" and "net output" contracts (issues 1a, 5b, 8 and 9). PPL/408 (Partial Stipulation). The parties also appear to have resolved most of their disputes regarding standard form contracts for off-system QFs (issues 14a through 14e).

ALJ Kirkpatrick issued a ruling on May 4, 2006, establishing a briefing schedule. <u>Re Staff's Investigation Relating to Elec. Util. Purchases from QFs</u>, OPUC Docket No. UM 1129, Ruling (May 4, 2006). ALJ Kirkpatrick also requested that the parties address each specific issue in this proceeding or indicate that they do not have a position. <u>Id.</u> ICNU and Weyerhaeuser do not have a position on issues 2, 4, 5b, 6, 7 and 10 regarding the default security requirements, mechanical availability guarantees, the definition of nameplate capacity, the cap on the amount of default losses, liability

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insurance for QFs under 200 kW, and the role of Staff. ICNU and Weyerhaeuser do not take a position on issue 12 regarding whether an Oregon utility should be required to enter into a new QF contract if it has been relieved of its mandatory purchase obligation under PURPA, except that ICNU and Weyerhaeuser believe this issue is not ripe and should be addressed in the future if the Federal Energy Regulatory Commission ("FERC") relieves an Oregon IOU of its PURPA obligations.

ALJ Kirkpatrick also directed the parties to "list the guidelines for the negotiation of QF power purchase contracts that they recommend." Id. Attachment A to this Opening Brief includes ICNU and Weyerhaeuser's recommended guidelines. As explained below, ICNU and Weyerhaeuser have sought to adopt or modify the reasonable proposals of Staff and PacifiCorp in order to develop clear and consistent guidelines and to assist the Commission in its resolution of this case. Therefore, Attachment A differs slightly from the proposals contained in ICNU and Weyerhaeuser's testimony.

III. ARGUMENT

A. The Commission Should Adopt Reasonable Guidelines for Adjusting the Avoided Costs to Reflect a QF's Power Supply Attributes (Issue 1d)

The Commission should adopt detailed and specific guidelines regarding how utilities and QFs can adjust a utility's avoided costs for the specific power supply attributes of a QF. The adoption of "specific guidelines will reduce the potential for QF-utility negotiations to reach impasses that either will frustrate QF development or require significant Commission resources to resolve through the complaint process." Weyerhaeuser-ICNU/304, Beach/3. The recommendations of ICNU and Weyerhaeuser

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may remove a significant barrier to cost-effective QF development and result in a more accurate calculation of the value of QF power.

The utilities' standard Commission-approved avoided cost rates are the starting point for negotiations between large QFs and the utilities. Order No. 05-584 at 12, 59; Weyerhaeuser-ICNU/300, Beach/11. FERC has established pricing factors that utilities and large QFs can use to adjust the standard avoided costs to set the rates for specific QF contracts. 18 C.F.R. § 292.304(e). The FERC factors are vague and have not provided sufficient detail to allow QF developers to successfully negotiate contracts in Oregon. The purpose of this track of the proceeding is to provide specificity for these factors so that utilities and QF developers can easily understand how these factors should be used to adjust the price of QF power. Specifically, the Commission will determine:

> How should avoided costs be adjusted for factors, such as those described in 18 CFR § 292.304, for a Qualifying Facility's specific power supply attributes and commitments?

OPUC Docket No. UM 1129, Ruling, Appendix A at 1 (Mar. 3, 2006).

In direct testimony in this proceeding, ICNU, Weyerhaeuser, and Staff provided the Commission with detailed proposals regarding the factors that should be considered when adjusting the avoided costs offered to large QFs. In contrast, the utilities' direct testimony lacked "the detailed guidelines that Order No. 05-584 requested." Weyerhaeuser-ICNU/304, Beach/2. For example, PacifiCorp offered limited discussion of the FERC pricing factors, but only in general terms and more specific descriptions of how only a few of the factors would be adjusted. Id. at Beach/2-3;

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PPL/404, Griswold/5-6; Weyerhaeuser-ICNU/305, Beach/3-4, 6-9. Through the discovery process and rebuttal testimony, PacifiCorp has provided the Commission with additional proposed guidelines and methodologies, and greater specificity regarding how its proposals would work. The Commission now has sufficient information to adopt detailed negotiating guidelines.

PGE has remained steadfast in its position that the Commission should not limit the utilities' discretion in the negotiating process. PGE has refused to identify any specific negotiating parameters or guidelines that should be used to limit its discretion in negotiations with QFs, and PGE's testimony and discovery responses have provided the Commission and QFs with no additional information regarding how PGE would adjust its avoided costs to reflect the characteristics of large QFs than when this proceeding was first initiated. PGE insists that it should continue to have nearly unfettered flexibility to refuse to enter into QF contracts. Weyerhaeuser-ICNU/306, Beach /3-5; PGE/500, Kuns-Sims/3-7. PGE asserts that it will rely upon the FERC factors, but that no more specificity is needed and that it will "adjust the avoided costs on a case-by-case basis, based on the attributes of the QF with which it is negotiating." Weyerhaeuser-ICNU/304, Beach/3; Weyerhaeuser-ICNU/306, Beach/3-5; Weyerhaeuser-ICNU/309, Beach/3-4. According to PGE, "the most important parameter to support successful non-standard QF contract development" is "flexibility." PGE/500, Kuns-Sims/8.

PGE's position is inconsistent with Order No. 05-584 and would have the practical effect of continuing to provide the utilities with the ability to prevent QF development by offering unfair pricing to large QFs. The Commission has already determined that large QFs face market barriers and that these barriers should be eliminated by improving "negotiation parameters and guidelines and greater transparency in the negotiation process." Order No. 05-584 at 17. Instead of complying with Order No. 05-584, PGE wishes to maintain the current "flexibility" that it has when negotiating contracts with QFs. Weyerhaeuser-ICNU/309, Beach/6. This "flexibility" has resulted in QFs making up only 0.7% of Oregon's installed generation capacity, and QF serving less than 0.5% of PGE's load. ICNU/102, Schoenbeck/1 (Exhibit to ICNU direct testimony in Phase I—August 3, 2004); Weyerhaeuser-ICNU/309, Beach/1. The Commission should reject PGE's approach because it will continue the status quo and could eliminate any possibility for large QFs to successfully enter into contracts with Oregon utilities.

1. The Dispatchability and Reliability Adjustments to the Utilities' Avoided Costs Should Be Adjusted Based on the QF's Availability During Peak Periods

ICNU and Weyerhaeuser propose that the reliability and dispatchability factors used to adjust the avoided costs offered to large QFs should be based on the QF's "availability during the utility's peak period." See Weyerhaeuser-ICNU/304, Beach/4. In testimony, ICNU and Weyerhaeuser proposed separate adjustments for reliability and dispatchability. These separate adjustments are reasonable; however, ICNU and Weyerhaeuser believe that both reliability and dispatchability can be reflected in a single adjustment to a QF's on-peak capacity payment based on the QF's achieved on-peak capacity factor. As explained below, ICNU and Weyerhaeuser's agreement to a single reliability/dispatchability adjustment represents a partial acceptance of PacifiCorp's proposal regarding reliability and dispatchability. However, ICNU and Weyerhaeuser

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depart from PacifiCorp's proposal to only lower the avoided costs due to reliability and dispatchability, because these factors should increase or decrease the final avoided costs for large QFs depending on the availability of the QF resource.

a. The Positions of the Parties Regarding Reliability

All parties agree that the avoided costs offered to large QFs should be adjusted based on the QF's reliability. The FERC pricing factors state that the avoided costs offered to QFs should be based on the "expected or demonstrated reliability of the qualifying facility." 18 C.F.R. § 292.304(e)(2)(ii). ICNU and Weyerhaeuser proposed that QF contracts "should provide incentives for reliable performance, through fixed dollar per kW-year capacity payments (based on the fixed costs of the avoided resources) that are tied to performance during the utility's peak time-of-use ("TOU") period." ICNU-Weyerhaeuser/300, Beach/12. Staff generally agreed with this proposal. Staff/1800, Schwartz/11; Staff/2300, Schwartz/5-8. PacifiCorp proposed that the rates paid to QFs should be adjusted based on the facility's operating reliability and capacity production capability as compared to the proxy resource. PPL/404, Griswold/6. PacifiCorp's reliability adjustment could lower the avoided costs for unreliable QFs, but would not increase the avoided costs for more reliable QFs. Id.; PPL/407, Griswold/14-15. PGE and Idaho Power did not propose specific methods to account for reliability.

b. The Positions of the Parties Regarding Dispatchability

All parties also agree that the avoided costs should be adjusted based on dispatchability. The FERC pricing factors state that the avoided costs can be adjusted by taking into account the "ability of the utility to dispatch the qualifying facility." 18

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C.F.R. § 292.304(2)(i). ICNU and Weyerhaeuser proposed a dispatchability adjustment in testimony noting that dispatchability "is an economic issue that should be handled through accurate time-differentiated avoided cost rates, with lower off-peak rates that reflect the utility's avoided costs during low-demand periods." Weyerhaeuser-ICNU/300, Beach/13-14.

ICNU and Weyerhaeuser's dispatchability proposal was resisted by Staff and the utilities. For example, Staff objected because Staff believes that time-differentiated rates do not fully capture the real-time value of dispatchability. Staff/2300, Schwartz/8. Staff and Idaho Power proposed that stochastic integrated resource planning ("IRP") models be used to value dispatchability. Staff/1800, Schwartz/11; Idaho Power/400, Gale-Allphin/9. PGE has not made a proposal and has not provided the Commission or potential QF developers with any indication regarding how it would adjust its avoided costs for dispatchability (or any other FERC factor). Weyerhaeuser-ICNU/306, Beach/3-5.

Similar to its reliability adjustment, PacifiCorp proposed that dispatchability be based on the difference between the availability of the QF and the proxy resource. PPL/404, Griwsold/6. PacifiCorp's dispatchability adjustment could decrease, but not increase, capacity payments. Id. PacifiCorp also proposed that one adjustment be made to reflect both dispatchability and reliability. Id. PacifiCorp provided additional information in the discovery process that explained how its proposal would work. Weyerhaeuser-ICNU/305, Beach/1; Weyerhaeuser-ICNU/308, Beach/1-3.

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c. ICNU and Weyerhaeuser Support the Concept that Reliability and Dispatchability Can Be Based on the Actual Availability of the QF Resource

Although ICNU and Weyerhaeuser continue to believe that dispatchability can be accurately valued based on time differentiated rates, PacifiCorp's proposed adjustment for reliability and dispatchability is a reasonable alternative, if it is used to both increase and decrease avoided costs. PacifiCorp's proposal has merit because it compares the reliability and availability of the QF resource to the proxy resource, and adjusts the price paid to the QF based on actual resource availability. Weyerhaeuser-ICNU/305, Beach/1. It is also consistent with ICNU and Weyerhaeuser's position that reliability and dispatchability are economic issues that should be based on the physical reliability and availability of the QF resources. Weyerhaeuser-ICNU/300, Beach/12-14. QFs should not be penalized if they cannot provide physical dispatch, but should be compensated based on whether they were available in comparison to the reliability and availability of the utility's proxy resource. Attachment A summarizes ICNU and Weyerhaeuser's understanding of how this adjustment would be utilized.

d. Reliability and Dispatchability Adjustments Should Accurately Value QF Power

The Commission should reject PacifiCorp's proposal to use the reliability and dispatchability factors only to decrease the avoided costs provided to QFs. PacifiCorp's proposal also should be modified to recognize that QFs provide capacity values even when they are less available than the proxy resource. PacifiCorp's specific proposal is that a QF would receive full avoided cost rates if the QF has an equal or

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greater availability than the proxy resource. Staff/2300, Schwartz/5. In contrast, if the QF is below the proxy resource's availability, then the QF would receive no capacity contribution in its on-peak price and receive only off-peak prices for all energy delivered. Id. Under PacifiCorp's proposal, a QF would be penalized if it was less reliable than the proxy resource, but the value of QF power could not be increased if a QF was more reliable than the proxy resource. Id.

The Commission should adopt a balanced approach that penalizes QFs for being less available than the proxy resource, but recognizes the higher value of the power if the QF is more reliable. The FERC pricing factors are not "a one-way street that only serve to reduce avoided costs for large QFs; QFs also should have the ability to earn additional payments for performance superior to the proxy plant." Weyerhaeuser-ICNU/304, Beach/5. A balanced approach is not only fair to the QF, but accurately values QF power by reducing payments to QFs that are unreliable, while increasing payments to QFs that demonstrate superior reliability. See Staff/2300, Schwartz/5-8.

Staff has proposed a reasonable "sliding scale model to calculate adjustments to capacity payments for actual monthly QF performance . . . ." Staff/2300, Schwartz/6. Staff proposes that "the QF should receive a higher monthly capacity payment than is embedded in standard on-peak rates" if the QF's availability during on-peak hours exceeds the availability of the proxy resource. Id. at Schwartz/8. ICNU and Weyerhaeuser agree with Staff that the availability should be compared to the proxy resource and not the QF's contract capacity level.

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ICNU, Weyerhaeuser and Staff also agree that QFs provide capacity value even if the QF is less available than the proxy resource. PacifiCorp's proposal eliminates capacity payments for all QFs that are less available than its proxy resource (which has an 84.2% on-peak capacity), and does not distinguish between a QF that has an on-peak capacity of 20% and a QF with an on-peak capacity of 80%. Id. at Schwartz/6. This is unfair because there should be a distinction in capacity payments between a QF that is slightly less reliability than the proxy resource and one that is very unreliable. Staff's sliding scale method makes this distinction and should be used to reflect the difference in value provided by QFs with lower availability than the proxy resource.

e. Dispatchability Should Not Be Valued by IRP Modeling

ICNU and Weyerhaeuser strongly disagree with the proposals by Staff and Idaho Power to base the dispatchability adjustment on stochastic IRP modeling. These proposals are ill-defined, not sufficiently detailed, would provide no specific guidance to QFs or utilities, and were not fully made until the rebuttal phase of this proceeding. See Staff/2300, Schwartz/9-10; Idaho Power/400, Gale-Allphin/9. The Commission should not allow the utilities to rely upon IRP modeling because it will not provide any guidance to QF developers and the utilities, lead to less transparent negotiations, and will provide the utilities with another tool to exacerbate the unequal bargain positions of the parties.

In rebuttal testimony, Staff provided an explanation of its proposal to use IRP modeling to determine the value of the difference in dispatchability between a utility proxy plant and a combined heat and power ("CHP") facility. Staff/2300, Schwartz/9-10. The utility would use its IRP model to compare the value of the utility's "base" resource

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portfolio including its proxy plant with a resource portfolio that includes the CHP facility. Id. This would be used to obtain a dollar value that would reduce the avoided cost rates offered to the QF. Id. Idaho Power has used this method in Idaho and it has significantly reduced the value of the avoided costs offered to large QFs. Despite the fact that numerous QFs have entered into standard contracts with Idaho Power, no large QF developers have been able to enter into contracts with Idaho Power based on prices developed with Idaho Power's IRP model. Weyerhaeuser-ICNU/310, Beach/1; Idaho Power/300, Gale/3-5; Staff/2301, Schwartz/8-9.

Valuing dispatchability through an IRP model would allow the utilities to use their complex modeling programs to propose difficult to verify reductions in the value of the avoided costs offered to QF developers. QF developers generally do not participate in IRP or rate case proceedings due to the expense involved, and it would be extremely difficult for QF developers to understand or verify the adjustments because they are unlikely to have the expertise to test the accuracy of the proposed adjustments. In contrast, PacifiCorp's proposal to adjust dispatchability based on the QF's availability and ICNU and Weyerhaeuser's original proposal to value dispatchability based on time differentiated pricing are easily understood, verifiable, and will reduce rather than increase the opportunities for disputes and utility obfuscation.

2. Transmission and Line Losses

The avoided costs for large QFs should be adjusted based on the line losses, locational effects, and impact the QF has on the utility's transmission and distribution costs. Weyerhaeuser-ICNU/300, Beach/15. This is consistent with the

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FERC pricing factors that include adjustments related to the "costs and savings resulting from variations in line losses," the value of the QF's energy and capacity, and the ability of the utility to avoid other costs. 18 C.F.R. §§ 292.304(e)(2)(vi); .304(e)(3); .304(e)(4). ICNU and Weyerhaeuser recommend that the transmission and distribution adjustments be based on the utilities' recognized transmission plans and load flow studies, and line losses should be based on the use of the loss factors in the utilities' Open Access Transmission Tariffs ("OATT"). These adjustments should both decrease and increase the value of QF power.

Transmission studies can be performed to determine if the QF's location results in its output having "a substantially different impact on a utility's line losses and transmission costs than does the avoided resource." Weyerhaeuser-ICNU/300, Beach/15. Since "QF developers often lack the means or expertise to review or challenge" these transmission studies, "the utility's studies should be based on transmission plans and load flow studies" that are generally used by the utility and "have been reviewed and approved by state regulators or by a regional transmission or reliability organization." Weyerhaeuser-ICNU/304, Beach/9. Staff generally agrees that the avoided costs offered to QFs at or near load centers should reflect the reduction in transmission costs, savings at the distribution level, and line loss savings. See Staff/1800, Schwartz/14-15; Staff/2300, Schwartz/11.

PacifiCorp has proposed the most detailed methodology regarding a line loss adjustment, and this proposal is a good starting point for developing a guideline applicable to all of the Oregon utilities. See PPL/407, Griswold/5-6; Weyerhaeuser-

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ICNU/305, Beach/6; Weyerhaeuser-ICNU/308, Beach/11. PGE and Idaho Power have not proposed any methodologies or provided any guidance regarding how line losses would be used to adjust their avoided costs. E.g., Idaho Power/400, Gale-Allphin/11. PacifiCorp's methodology would be in lieu of performing a specific study to estimate line losses, and is based on the loss rates in its OATT and the proximity of the QF to a load center and the proxy resource. PPL/407, Griswold/2-4; ICNU/308, Beach/15.

ICNU and Weyerhaeuser can support PacifiCorp's proposal, if the following clarifications or corrections are made. PacifiCorp appears to have taken two different positions on whether the "load area" in PacifiCorp's proposal is the nearest load area to the QF resource or the closest load center to the proxy resource. Weyerhaeuser-ICNU/308, Beach/12-13. The appropriate load center should be the load center that the QF's power would actually be used to serve and should refer "to any load or an accumulation of load within the closest proximity of the QF generator." Id. at Beach/13. For example, a line loss adjustment should not be based on the assumption that an Oregon QF's power will be wheeled to a load center closest to PacifiCorp's Utah proxy resource. Such an adjustment ignores how the power will actually be used and the actual line losses that would occur (or be avoided), and would have the practical effect of imposing an unnecessarily high line loss penalty on Oregon QFs.

PacifiCorp's proposal may not be appropriate for all circumstances. For example, PacifiCorp's proposal only makes sense if there is a significant difference between the distance between the QF and its load center and the distance between the proxy resource and its load center. Thus, there may be circumstances in which a full line

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loss adjustment may not be appropriate and large QFs should have the option of requesting that the utilities perform a line loss study to obtain a more accurate adjustment.

Other transmission and distribution related costs and savings should be accounted for in the negotiating process. ICNU and Weyerhaeuser agree with Staff's proposal that transmission upgrades should be separately charged as part of the interconnection process, instead of as a reduction to the avoided cost rates. Staff/2300, Schwartz/12. There is no need to estimate a reduction in the avoided costs for transmission upgrades if there is a specific and known cost to integrate the QF with the utility's transmission system, and the QF bears this up-front cost as part of its interconnection agreement with the utility. The costs of any upgrades should be consistent with FERC's standards, including the requirement that QFs should not be responsible for paying incremental costs of transmission upgrades that benefit the entire transmission system.

Other transmission savings should be reflected in the price offered to large QFs. ICNU/300, Beach/15; Staff/2300, Schwartz/11-12. Those distribution and "transmission costs that can be avoided or deferred as a result of the QF's location" should have an adjustment included in their avoided costs. Staff/2300, Schwartz/11. Although appearing to agree in principle that transmission savings should be reflected in their avoided costs, PacifiCorp suggests that there will be no savings associated with QFs under 100 MWs. ICNU/305, Beach/7. ICNU and Weyerhaeuser disagree that QFs smaller than 100 MWs cannot provide the utilities with transmission savings. QF

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resources in aggregate can result in the deferral or avoidance of transmission upgrades. See 18 C.F.R. § 292.304(e)(2)(vi). Large QFs should receive a pro rata share of any transmission savings to which they contribute. Any other result would deny QFs the benefits they provide to the transmission system while requiring them to pay for the costs they impose upon the transmission system.

3. Termination, Scheduling Outages, and Emergencies Should Be Addressed with Appropriate Contractual Provisions

ICNU and Weyerhaeuser propose that the FERC factors related to termination, scheduling outages, and system emergencies should not be used to adjust the avoided costs, but can be addressed in the QF-utility contract. Addressing these issues pursuant to contractual provisions is more appropriate because no party has proposed any specific methodologies to use to adjust the avoided cost for these factors, and these issues can be adequately addressed through reasonable contractual provisions. ICNU and Weyerhaeuser have proposed contractual language on these issues that the Commission should acknowledge as one example of reasonable contractual provisions.

PGE appears to be the only party that does not believe that certain FERC pricing factors can be addressed in the contractual process or that standard industry contracts are reasonable for QF-utility contracts. PGE/500, Kuns-Sims/3-5. PGE does not, however, have any criticism of the specific contractual provisions, but disagrees with any limitations on its flexibility, including use of contractual provisions. PGE asserts that the use of contractual provisions would "diminish the importance of developing non-standard contracts (and standard contracts) that yield benefits to utility customers." Id. at

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Kuns-Sims/2. However, there can be no benefits to ratepayers if PGE never enters into any contracts with cost-effective QFs. PGE's position on the use of contractual provisions demonstrates that PGE will object to even the most basic and reasonable limitations on its discretion.

Reasonable termination provisions should be included in the utility-QF contract. For example, a clause should be included to "keep the ratepayer whole if a QF receives capacity payments that are front-loaded or levelized compared to the comparable costs that the utility would recover in rates . . . ." Weyerhaeuser-ICNU/300, Beach/14. A QF that terminates its contract before its term expires should be liable for damages. Id. Weyerhaeuser and ICNU have provided contractual language that is a reasonable "termination clause that requires the repayment of unrecovered front-loaded capacity payments." Id.; Weyerhaeuser-ICNU/302.

ICNU and Weyerhaeuser also agree with Staff, Idaho Power, and PacifiCorp that there are other damages a utility may incur if a QF terminates its contract early. Staff/2300, Schwartz/10; Idaho Power/400, Gale-Allphin/12; PPL/304, Wessling/1-2. ICNU and Weyerhaeuser support Staff's proposal that the termination provisions for large QFs be generally the same as those for standard contracts. Staff/1800, Schwartz/12. Termination provisions should also be consistent with standard industry practice regarding purchase power agreements, and the guidelines the Commission adopts should recognize that the utilities should not be permitted to impose more onerous obligations on QFs. Staff and Idaho Power appear to agree that damages

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and other contract provisions should not be more burdensome than standard utility industry contracts. Staff/1800, Schwartz/8; Idaho Power/400, Gale-Allphin/3.

It is reasonable for the QF-utility contract to "specify that QFs should schedule major maintenance outages during non-peak months" and that QFs "provide the utility with reasonable advance notice of such outages." Weyerhaeuser-ICNU/300, Beach/14; Weyerhaeuser-ICNU/302, Beach/3. QFs should be provided a reasonable allowance for scheduled maintenance, and "scheduled maintenance hours that are within the QF's allowance should not be used to calculate the QF's achieved capacity factor used to determine capacity payments." Weyerhaeuser-ICNU/300, Beach/14-15. Weyerhaeuser and ICNU agree with Staff's suggestion that provisions in the utilities' standby tariffs can provide guidance regarding reasonable scheduled maintenance provisions. Staff/1800, Schwartz/12-13.

ICNU and Weyerhaeuser propose that QF-utility contracts include "a 'best efforts' obligation to deliver their contract capacity to the utility during system emergencies, which should be defined as a period when the integrity of the utility's system is threatened." Weyerhaeuser-ICNU/300, Beach/15; Weyerhaeuser-ICNU/302. Staff supports this approach and clarifies that "the QF should not be penalized for an unplanned outage during a utility system emergency . . . ." Staff/2300, Schwartz/11. Based on a review of their testimony, PacifiCorp and Idaho Power do not appear to disagree that emergencies should be addressed through a best efforts contractual requirement.

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4. Other FERC Authorized Pricing Factors

There are other FERC pricing factors for which ICNU and Weyerhaeuser do not recommend that the Commission adopt specific guidelines that will adjust the avoided costs for large QFs. Some of these pricing factors would typically increase the price of QF power. For example, the FERC pricing factors include the individual and aggregate value and capacity of QF power, and the smaller capacity increments and shorter lead times of QF resources. 18 C.F.R. §§ 292.304(e)(2)(vi); .304(e)(2)(vii). The aggregate value of QF production can be greater than a single QF because it understates the value of having QFs on the electric power system. Weyerhaeuser-ICNU/300, Beach/16. Similarly, "QFs provide a utility with a more diverse mix of resources and with a more dispersed and resilient generation portfolio" that provides benefits that are difficult to incorporate into the price offered to QFs. Id. at Beach/16-17.

Instead of adopting specific methodologies to adjust for these factors, the Commission should consider these factors when reaching its conclusions on other issues in its final order. For example, the diversity value and aggregate value of QF power can be reflected in providing QFs with the opportunity to earn additional capacity payments for performance superior to the avoided resource, as discussed in ICNU and Weyerhaeuser's reliability guideline. Similarly, the aggregate value of QF resources should be considered when the Commission decides whether to require the utilities to compensate QFs for their contribution to avoided transmission costs.

In addition, the utilities have argued that QFs are paid a premium over power purchased in competitive generation markets, and against limiting their own

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flexibility, while simultaneously arguing that large QFs should not have the option to select the pricing methods available to small QFs. Although ICNU and Weyerhaeuser believe these utility arguments should be rejected on their merits, the Commission should consider the utilities' positions in the context that there are no proposed methodologies to account for these FERC pricing factors that usually increase the value of QF power.

Staff has proposed that the FERC factors related to the individual and aggregate value and capacity of QF power, and the smaller capacity increments and shorter lead times of QF resources, be considered based on the utilities' IRP models. As explained above regarding dispatchability, ICNU and Weyerhaeuser generally do not support the use of IRP modeling to calculate the value of QF power. However, if the Commission decides to use IRP modeling to value dispatchability, the Commission should require the modeling to include the aggregate value of QF power and value of smaller capacity payments.

Staff also notes that the Commission is considering whether to assign a risk mitigation value for non-fossil fuel resources in the resource planning and competitive bidding process. Staff/1800, Schwartz/14. Although ICNU generally opposes arbitrarily increasing the costs of resources in the planning process to achieve environmental goals, all resources should be treated fairly if the Commission assigns risk mitigation values for non-fossil fuel resources. If a "CHP project can demonstrate that it uses natural gas more efficiently than the proxy" plant, then "the CHP project should receive the same natural gas price mitigation value (if any) as a renewable generator that conserves an equal amount of natural gas." Weyerhaeuser-ICNU/304, Beach/7.

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Evidence in this proceeding demonstrates that gas-fired CHP projects provide natural gas price mitigation benefits roughly equal to 40% of that provided by renewable energy and conservation. Id. at Beach/7-8.

B. The Utilities Should Not Be Permitted to Adjust the Avoided Cost Calculations Based on Factors that Have Not Been Approved by the Commission (Issue 1f)

ICNU, Weyerhaeuser, and Staff agree that the utilities should not be allowed to modify the avoided costs rates in ways in which the Commission has not provided guidance in this proceeding. Weyerhaeuser-ICNU/300, Beach/24; Staff/1800, Schwartz/15-16. First, the FERC rules appear to be an "all inclusive list" and specify "*all* the factors that can be taken into account." Staff/1800, Schwartz/15-16 (emphasis in original). It is unclear whether the Commission has the authority to allow the utilities to use additional non-FERC approved factors to adjust their avoided costs.

Allowing the utilities to unilaterally create additional factors to adjust their avoided costs is inconsistent with the purpose of this proceeding, which "is to streamline and clarify the negotiating process by specifying the parameters within which negotiations will occur." Weyerhaeuser-ICNU/300, Beach/24; Staff/1800, Schwartz/16. If the utilities believe that additional factors should be considered, then they should have raised "that issue in this proceeding for a Commission decision." Staff/1800, Schwartz/16. Except for debt imputation and project location, PGE and PacifiCorp could not identify any other factors that they would utilize to adjust the avoided costs offered to large QFs. Weyerhaeuser-ICNU/305, Beach/3; Weyerhaeuser-ICNU/306, Beach/2. The

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utilities should not be permitted to impose factors in the negotiating process that they were unable to identify in this proceeding.

C. Debt Imputation Should Not Be Used to Adjust the Avoided Costs for Large QFs (Issue 13)

Debt imputation should not be considered in setting avoided cost rates for large QFs. The evidence in this proceeding demonstrates that debt imputation does not impose a real or measurable cost on the utilities when they enter into contracts with QFs. Debt imputation should also be rejected because the utilities did not identify this cost in their avoided cost filings, but only seek to use debt imputation as an arbitrary and unnecessary barrier to the development of certain QFs.

The utilities argue that the avoided costs for large QFs should be reduced to address their alleged cost increases associated with the risk of long-term QF purchased power agreements ("PPAs"). The utilities' argument is that PPAs require fixed payments that are "debt like" for rating agency purposes. Staff/2000, Morgan/4. Since there is a fixed payment associated with the PPAs, the utilities argue that there is an impact on their cost of capital that should be included in the avoided cost calculation for large QFs. Id. PacifiCorp also argues that debt imputation is appropriate because a QF contract could be considered similar to a lease. PPL/404, Shah/1-2.

The Commission should not permit the utilities to utilize debt imputation in negotiating the avoided costs for large QFs because "there is no evidence that QF contracts require an adjustment for a 'debt imputation' effect." Staff/2000, Morgan/4. The utilities' position that their cost of capital will increase due to QF contracts is based

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on a number of fallacies. A utility's cost of capital is based on numerous factors and it is difficult to ascribe any particular factor to cost of capital. Staff/2500, Morgan/7-13. Even if QF PPAs had a negative impact, there is no "support that the incremental cost of capital would increase." Staff/2000, Morgan/4-5. In fact, the evidence in this proceeding demonstrates that the impact of PPAs on the utilities' cost of capital has not been proven to be negative. Staff/2500, Morgan/7-13.

The utilities' arguments also fail because, even if generic PPAs impose a cost that could be calculated, there is no evidence that QF PPAs impose any costs. Weyerhaeuser-ICNU/304, Beach/11-12. QF contracts are different from and are treated more favorably than generic PPAs because they "are blessed by overarching federal legislation" that results in a lower risk factor than standard PPAs. See Weyerhaeuser-ICNU/303, Beach/3. For example, PacifiCorp was unable to quantify any increased debt imputation costs that the Company has actually experienced due to its existing QF contracts. ICNU/308, Beach/10. Similarly, "it does not appear that existing QF contracts include an offset for debt imputation." Weyerhaeuser-ICNU/304, Beach/12; Weyerhaeuser-ICNU/305, Beach/15-16.

The utilities' argument should be rejected because there is no fair way to quantify the alleged cost associated with debt imputation for PPAs. There is no uniform method to adjust for debt imputation by rating agencies, nor is there any "single formula for calculating the financial impacts of the debt equivalence of QF PPAs." Weyerhaeuser-ICNU/304, Beach/11; Staff/2000, Morgan/5. S&P is the only rating agency that has proposed a methodology; however, "significant judgment is involved in

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these calculations, even under S&P's quantitative method." Weyerhaeuser-ICNU/304, Beach/11-12; Weyerhaeuser-ICNU/305, Beach/12-14; Staff/2500, Morgan/3. Essentially, it is not possible to "accurately quantify the marginal cost associated with the risk due to the use of a PPA." Staff/2000, Morgan/9.

Debt imputation also should not be a factor in negotiating large QF contracts, because "it would be administratively difficult, if not impossible to direct companies to calculate additional costs associated [with] imputed debt on an agreement-by-agreement basis . . . ." Staff/2500, Morgan/3. This is demonstrated by the fact that PacifiCorp could not provide a specific methodology that it would use to adjust for debt imputation. ICNU/308, Beach/8.

There is also no legitimate basis to treat large QFs differently than small QFs. The utilities' avoided cost filings do not include debt imputation. Weyerhaeuser-ICNU/305, Beach/11. If the Commission allows the utilities to impose these phantom costs on large QFs in the negotiating process, then large QFs alone would "bear the costs of debt imputation." Weyerhaeuser-ICNU/304, Beach/12. If the Commission believes that debt imputation imposes a real and measurable cost, then "that cost should be reflected in the utility's filed avoided cost calculations, which apply directly to small QFs and are the starting point for negotiations with large QFs." <u>Id.</u>

Finally, PacifiCorp's argument that a QF contract is treated as a capital lease does not apply to most, if any, large CHP QFs. Weyerhaeuser-ICNU/304, Beach/10. According to PacifiCorp, a QF contract will be considered a lease only if the utility has the right to operate or control the plant, or if it is unlikely that other purchasers

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will buy more than 10% of the plant's output. PPL/700, Stuver/3. These conditions are not "likely to occur in typical QF contracts with CHP projects." Weyerhaeuser-ICNU/304, Beach/10. CHP projects are not operated by the utilities, and "it is extremely unlikely that a CHP QF's sales to the utility will amount to more than 90% of its output" because of FERC rules and the fact that a portion of the energy may be sold or provided to the on-site host. Id. In addition, FERC's recent order implementing the Energy Policy Act of 2005 requires new cogeneration QFs to provide 50% of their output energy to a purchaser other than the local utility or justify why their output is not fundamentally for sale to an electric utility. Revised Regulations Governing Small Power Production and Cogeneration Facilities, Docket No. RM05-36, Order No. 671 (Feb. 2, 2006). Thus, new projects that sell 90% of their output to the utility are highly unlikely to be considered a QF.

D. The Negotiation Process (Issues 1d and 1e[1/])

The purpose of the negotiating process between a large QF and a utility is to develop accurate avoided costs that reflect the project specific characteristics of the QF and its impact upon the utility's electric power system. The starting point for these negotiations is the utility's avoided costs. Order No. 05-584 at 12, 59. When a utility presents its pricing proposal to a potential QF developer, "the utility should state in

1/ Issue 1e addresses PacifiCorp's Schedule 38. ICNU and Weyerhaeuser do not have specific objections to the generic requirements in Schedule 38, and urge the Commission to require Idaho Power and PGE to file similar tariffs detailing the negotiation process for large QFs. However, Schedule 38 may need be revised to reflect the Commission's final order in Phase II Track II regarding certain issues, including, *inter alia*, whether PacifiCorp is required to identify how it calculated the indicative pricing proposal and if PacifiCorp can utilize non-Commission approved factors to adjust the avoided costs for large QFs.

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writing how it has modified the indicative prices from the standard rates, and should provide the quantitative basis for each such adjustment." Weyerhaeuser-ICNU/300, Beach/23. Under the current rules, a "QF is left in the dark to guess at how the utility derived the indicative prices from the standard avoided cost rates." Id. Requiring the utilities to identify each factor that it used to adjust the avoided costs and the method the utility used for each factor could dramatically increase the transparency of the negotiating process.

PGE objects to a requirement that the utility identify how it modified its avoided costs to obtain a pricing proposal for a QF developer.[2/] In discovery, PGE stated that it objects to such a requirement because "PGE does not know the nature of the information the statement is intended to convey, the purpose of the statement or how providing a statement would affect timing for developing a contract . . . ." ICNU/309, Beach/4.

PGE's position reflects the twisted logic that PGE continues to rely upon to retain complete flexibility and maintain the current barriers impeding the development of cost-effective QFs. PGE is well aware that it has an advantage in the negotiating process because QFs do not know how PGE calculates the prices offered to the QF and, thus, the QFs are unable to ascertain whether the utility's adjustments are reasonable. The purpose of the requirement that the utility provide an explanation of how it calculated the prices offered to a QF is to make the negotiation process more open and

[2/] Based on a review of their testimony, Idaho Power and PacifiCorp did not appear to support or oppose this requirement.

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reduce the utility's ability to rely upon the tactics of obfuscation and stonewalling. This requirement is especially relevant for PGE because PGE is the utility that has been the least willing to provide any insights to the Commission or the parties in this proceeding regarding how it would adjust its avoided costs for large QFs.

E. Large QFs Should Have All the Pricing Methods Available to Small QFs (Issue 5a)

Large QFs should have the same pricing options as are available to QFs eligible for standard contracts. Providing large QFs with pricing options will more accurately value avoided costs, encourage the development of gas-fired QFs, and will treat large QFs fairly and equitably.

In Phase I of this proceeding, the Commission adopted pricing structures for the utilities to compute the avoided costs for standard contracts. The Commission directed all of the Oregon utilities to offer three pricing options: 1) the Fixed Price Method; 2) the Deadband Method; and 3) the Gas Market Method. Order No. 05-584 at 34. PGE was also directed to adopt a Mid-C Index Rate Option, and PacifiCorp was directed to work with the parties to determine if it should offer an indexed pricing option. Id. at 35. The most significant difference between the options is whether the gas price component of the utilities' avoided costs will be based on the natural gas price forecast in the utilities' last avoided cost filing, or on monthly natural gas price indexes. Id. at 32.

The Commission concluded in Phase I that QFs eligible for standard contracts should not have their pricing options limited because "the adoption of more pricing options for QF standard contracts is consistent with our goal, in this proceeding,

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to more accurately value avoided costs." Id. at 34. The Commission recognized "that a QF is in the best position to select a pricing option that best suits its operations," and "that fairness and administrative ease call for all eligible QFs to have the same set of pricing options . . . ." Id. The Commission rejected proposals to limit the availability of certain pricing options and prevented the utilities from imposing "qualifications regarding the ability of an eligible QF to choose among these options." Id.

The Commission's reasoning regarding the pricing options for standard contracts in Order No. 05-584 supports providing large QFs with the same pricing options. Similar to QFs under 10 MW, large QFs should be able to select the pricing methodology that is consistent with their operational characteristics and risk portfolio. As demonstrated in the Commission's review of the utilities' compliance filings, the utilities' natural gas forecasts are controversial and unlikely to be accurate predictors of actual natural gas prices. For many gas-fired QFs, natural gas indexing will allow the QF to avoid reliance upon the utilities' natural gas forecasts, and reduce their operational risk and obtain more stable output. See Weyerhaeuser-ICNU/300, Beach/25.

PacifiCorp argues that large QFs should not be permitted to utilize the gas index options because they "disregard[] avoided costs." PPL/407, Gridwold/9. PacifiCorp and Idaho Power argue that large QFs should not be permitted to select from the available pricing options because it would expose the utilities to fluctuations in the price of natural gas. PPL/407, Gridwold/9-10; Idaho Power/400, Gale-Allphin/12-13.

Idaho Power also asserts that it has elected not to construct a base load natural gas fired resource because of concerns about natural gas volatility, and should not

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be required to shoulder QF gas price risk that it avoided in its IRP. Idaho Power/400, Gale-Allphin/12-13. ICNU and Weyerhaeuser agree in theory with Idaho Power: the utilities should only be required to offer a gas price index option if the utility has selected a gas-fired resource as its proxy plant.

The gas indexed options should be available to all QFs, if the utility's proxy resource is a gas-fired plant, because those utilities are already exposed to the risk of gas price changes. PacifiCorp and PGE have "sophisticated risk management and hedging programs with which they are able to manage gas price risk, even as it relates to QF contracts." Staff/1900, Chriss/9. Utilities could mitigate the risk of gas-indexed QF contracts and be neutral as to whether the utility builds its proxy resource or enters into QF contracts.

The avoided costs for large QFs are based on the avoided costs that are used to calculate the rates for small QFs; the only question in this proceeding is whether large QFs will have the same option as small QFs to decide if the gas price component of the avoided costs will be based on the utility's gas forecast or a market index. There is no legitimate reason not to provide large QFs with the pricing options available to small QFs, because all QFs "will avoid the same utility market purchases during the sufficiency period and the same combined cycle gas turbine project when the utility is capacity-deficient." Weyerhaeuser-ICNU/300, Beach/25. While large QFs are required to negotiate with the utilities to adjust the avoided costs for the project specific attributes of the large QF, the project specific characteristics of large QFs are highly unlikely to result

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in "the large QF some how not avoiding the same resources or market purchases as small QFs." Id. at Beach/26.

Staff argues that the Commission should allow large QFs and the utilities to use any of the pricing options, but that large QFs should not have the same right to select a pricing option as small QFs. Staff/2400, Chriss/2. Although couched in terms of allowing flexibility in the negotiating process, Staff's proposal will have the practical effect of providing the utilities a veto over any choices made by large QF developers. The Commission should reject Staff's position for the same reason it did not adopt Staff's proposed limitations on the availability of pricing options in Phase I: avoided costs will be more accurate and fair if the QF is able to select a pricing option that best suits its operations. See Order No. 05-584 at 34.

F. The Power Supply Attributes for "As Available" or "Non-Firm" Power Should Be Differentiated Through Payment Terms (Issues 1b and 1c)

ICNU and Weyerhaeuser propose "that the 'firmness' of QF power supply commitments should be reflected first in the payment terms for QF contracts." Weyerhaeuser-ICNU/300, Beach/22. QFs are generally considered firm resources, unless the contract specifically states otherwise. Staff/1800, Schwartz/12. QF contracts that include appropriate provisions regarding term, termination, emergencies, outages, default, and other issues should be treated as firm, and adjustments to the price of power should be made based on the QF's actual availability. Weyerhaeuser-ICNU/300, Beach/22. Instead of termination, a QF that fails to perform should first have its contract capacity de-rated until it can demonstrate it can provide capacity at a higher level. Id.;

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see Staff/2300, Schwartz/7. Firm capacity QFs should be paid capacity payments based on their achieved capacity factor during peak periods, as discussed in ICNU and Weyerhaeuser's reliability guideline. QFs that are "as available" or "non-firm" should have their rates based on the power actually delivered during peak periods. Weyerhaeuser-ICNU/300, Beach/22-23.

G. PacifiCorp Should Offer a Market Price Option (Issue 5a)

The Commission should require PacifiCorp to offer a market price option, similar to the market price option currently offered by PGE. A market price option for PacifiCorp would assist QFs by providing QFs more options to meet their operational needs, and should not impose additional risks upon PacifiCorp.

The Commission directed the parties to consider a market price option for PacifiCorp and encouraged the parties to offer market index in this phase of the proceeding. Order No. 05-584 at 35. PGE already offers a market price option, and the Commission found that the unique circumstances of Idaho Power did not warrant requiring Idaho Power to offer a market price option. Id. A market price option for PacifiCorp should be adopted because it "would provide parity with PGE in terms of the pricing options offered to QFs in each utility's territory." Staff/1900, Chriss/5. A market price option would also provide more pricing options so that PacifiCorp can more accurately value its avoided costs, and would assist QF development by allowing QFs to select the option that best suits their operations. See Order No. 05-584 at 34.

PacifiCorp argues against requiring it to offer a market price option because the option would allegedly increase its risks. PPL/404, Griswold/20. The

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currently available index options for small QFs include two gas price indexes that place some risks upon PacifiCorp and its ratepayers. Staff/2400, Chriss/7-9. The market price option should be adopted because Staff testified that PacifiCorp already faces risks under the gas price indexes and Staff could not identify the additional risk placed on PacifiCorp by a market price index. Id.

H. The Utilities Should Not Be Permitted to Use the Competitive Bidding Process to Erect Another Barrier to the Development of Cost-effective QFs (Issue 11)

Competitive bidding should not be used to set the pricing for QFs because it would be inconsistent with the utilities' obligation under PURPA to purchase any energy and capacity that is made available at its avoided costs. While QFs should not be precluded from participating in utility competitive bids, the bidding process is rarely a realistic option for QFs because the bidding requirements are often inconsistent with the operational characteristics of many QFs. The Commission also should limit the ability of the utilities to unilaterally reduce their avoided costs or eliminate deficiency periods based upon the results of a competitive bidding process.

PacifiCorp proposes that competitive bidding should be used to set the prices for QFs 100 MWs or larger will contract terms of five years or longer. PPL/404, Griswold/24-25. Very large QFs that do not submit a winning competitive bid would not be eligible for a capacity payment and would only be paid for QF energy at off-peak prices. Id.

PacifiCorp's proposal is inconsistent with the Commission's previous conclusions in Order No. 05-584, is unworkable for many large QFs, and would

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effectively prevent many very large QFs from ever being able to enter into a QF contract with the utility. Providing no capacity value to very large QFs that do not participate in a competitive bidding process would violate PURPA and be inconsistent with the Commission's established policies regarding the value of capacity. Weyerhaeuser-ICNU/300, Beach/29; Staff/1800, Schwartz/44-45. PURPA requires a utility to purchase capacity that is made available to the utility. Weyerhaeuser-ICNU/300, Beach/29; Staff/2300, Schwartz/19. The Commission also has determined that QFs have a capacity value, even when the utility is resource sufficient. Order No. 05-584 at 27-28; Staff/1800, Schwartz/44. Thus, capacity still has value even if a utility has completed a competitive bidding process. Staff/2300, Schwartz/19-20.

Competitive bidding should not be used to set avoided costs because the bidding processes "are not tailored to the procurement of QF resources." Weyerhaeuser-ICNU/300, Beach/27. QFs often have difficulty meeting the bidding specifications and other operational requirements the utilities often seek because "QF resources often are powered by intermittent resources (as in the case of renewables) or are associated with industrial processes that have specific operating requirements (as in the case of CHP) . . . ." Id. Experience from other states suggests that requiring QFs to participate in the competitive bidding process harms QFs and provides the utilities "with another tool to stonewall and refuse to enter into contracts with cost-effective QFs." Id. at Beach/27-29.

Although Staff is opposed to requiring QFs to participate in competitive bidding, Staff has proposed an alternative process by which the avoided costs for very

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large QFs would be set based on the results of winning competitive bids. Staff/1800, Schwartz/39-43. PGE also suggests that the results from a competitive bid inform the negotiations for large QFs. PGE/400, Kuns-Sims/14-15. Staff's proposal is complex, would result in different pricing methodologies for large and very large QFs, raises numerous issues regarding how competitive bidding pricing would be used in the negotiating process, and could result in the need for additional Commission proceedings to flesh out the requirements for competitive bidding-based avoided costs. If the Commission intends to allow the utilities to use the results of a competitive bidding process, then the Commission should reject Staff's proposal and instead allow the utilities to incorporate the information obtained from their bidding process in their next avoided cost filing. In order to ensure that the utilities do not use the competitive bidding process as a one-way street to only lower avoided costs and postpone deficiency periods, "the utilities should be required to update their avoided costs whenever they determine that they need new long-term supply-side resources . . . ." Weyerhaeuser-ICNU/304, Beach/15.

I. The Standard Contracts for Off-System QFs Should Provide the Starting Point for Negotiations for Large QFs (Issue 3b)

PacifiCorp and PGE have proposed standard form contracts for off-system QFs. After some changes and clarifications proposed by Sherman County/JR Simplot and Staff, it appears that there are no remaining disputes regarding the terms of the off-system contracts for QFs under 10 MWs. QFs should be entitled to purchase their electric requirements from their load serving utility and sell their entire net output to any

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off-system utility at the off-system utility's avoided costs. While the specific terms may need to be adjusted to reflect the specifics of particular large off-system QFs, ICNU urges the Commission to require the utilities to follow the general provisions of the standard off-system QF contracts when they offer large QFs off-system contracts. In the event that the utilities believe provisions do not apply or are inconsistent with how power would be purchased from a large QF, the utility should identify the provision and provide an explanation to the large off-system QF of why a change in the standard off-system QF contract was made.

J. The Commission Should Reject PGE's Proposal for Commission Approval of QF Contracts

PGE has proposed that instead of adopting negotiating parameters and guidelines, the Commission should create a process to approve non-standard QF contracts. PGE/500, Kuns-Sims/6. PGE is seeking to relitigate the Commission's conclusion in Phase I that QF contracts will not be contingent upon Commission approval. Order No. 05-584 at 56; Staff/2300, Schwartz/14. PGE did not seek reconsideration of Order No. 05-584, and PGE should not be permitted to re-litigate the Commission's conclusions that it will not pre-approve QF contracts or that the Commission will require greater transparency and specificity in the negotiating process.

K. The Commission Should Approve the Partial Stipulation

The parties to this phase of the proceeding have entered into a partial stipulation that resolves issues related to the appropriate term and simultaneous purchase/sale options. The provisions regarding term provide large QFs with the same

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right as small QFs to unilaterally select a contract term up to twenty years. PPL/408, Griswold/11. The pricing will obviously change based on the term selected by the QF. Id. Essentially, large and small QFs would have the same options to select a contract length that best meets their operational needs.

The parties also agree that QFs shall have the right to sell to the purchasing utility their net output, and to purchase the QF host's on-site electricity requirements from the utility. Id. To exercise this right, the QF must comply with state tariffs and its agreements with the utility. Id. The avoided costs for large simultaneous purchase/sale QFs will be negotiated based on the same factors approved by the Commission for negotiations between other large QFs and utilities. A QF retains its right to sell power at wholesale, or to a utility other than its load serving utility. The "simultaneous purchase and sale" settlement clarifies that a QF that is being served by its load serving utility cannot sell power to an off-system utility and purchase electricity from the off-system utility at the off-system utility's retail rates. Id. For example, a QF in PacifiCorp's service territory could not enter into a simultaneous purchase and sale to sells its power to PGE and purchase power based on PGE's retail rates. The QF in PacifiCorp's service territory could sell its electricity to PGE based on PGE's avoided costs, but would need to purchase on-site electricity requirements from PacifiCorp (its load serving utility).

III. CONCLUSION

The Commission has an opportunity to remove significant barriers to the development of cost-effective QFs in Oregon by ensuring that there is greater

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transparency in the negotiating process and adopting reasonable negotiating parameters and guidelines. The Commission also can ensure greater accuracy in the utilities' avoided costs by ensuring that large QFs have the same pricing options that are available to QFs eligible to receive standard contracts and by adopting a market price index for PacifiCorp. The Commission's decision in this proceeding may significantly shape the electric power markets in Oregon at the start of the new millennium, and may directly impact whether large cost-effective renewable and CHP QFs will have any realistic opportunity to sell their electricity to the Oregon utilities.

Dated this 7th day of June, 2006.

Respectfully submitted,

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Attachment A

Weyerhaeuser/ICNU Guidelines for
Negotiated QF Contracts

Weyerhaeuser / ICNU Guidelines for Negotiated QF Contracts

1. **Term.** *Issue 1a. FERC Factor §292.304[e][2][iii].* QFs larger than 10 MW should have the unilateral right to select a contract term of up to twenty years. The contract length selected by the QF may impact other contractual issues, including, but not limited to, the avoided cost determination with respect to that QF.

2. **Reliability.** *Issue 1d. FERC Factor §292.304[e][2][ii].* QF contracts for firm power should provide incentives for reliable performance, through payments for capacity that are tied to the QF's achieved performance during the utility's peak period, with a reasonable allowance for forced outages. QFs should face symmetric incentives for superior performance and penalties for inadequate output. Accordingly, large QF capacity payments should be based on a "sliding scale" model, with 100% of the avoided capacity value paid for an achieved on-peak capacity factor equal to the projected capacity factor of the avoided proxy resource (84.2% for PacifiCorp).

   As-available or non-firm QFs should receive capacity payments based on the avoided cost of capacity (in $ per MWh) times the actual output of the QF (in MWh) during the peak period.

3. **Dispatchability.** *Issue 1d. FERC Factor §292.304[e][2][i].* Both reliability and dispatchability factors should be reflected in a single adjustment to a QF's on-peak capacity payment, based on the QF's achieved on-peak capacity factor, as discussed above under the Reliability guideline.

   To more closely approximate real-time prices, avoided cost rates during the sufficiency period should be either (1) indexed to the natural gas market prices; or (2) indexed to day-ahead on- and off-peak electric market prices.

4. **Termination.** *Issue 1c. FERC Factor §292.304[e][2][iii].* Termination provisions should keep ratepayers whole if a QF has received front-loaded capacity payments. Termination provisions should not be more burdensome than standard utility industry contracts. A reasonable termination clause is presented in Exhibit Weyerhaeuser-ICNU/302.

5. **Scheduled Maintenance.** *Issue 1d. FERC Factor §292.304[e][2][iv].* QFs should schedule maintenance outages during non-peak months, with reasonable advance notice to the utility. Exhibit Weyerhaeuser-ICNU/302 provides an example of a contract clause on maintenance scheduling.

6. **System Emergencies**. *Issue 1d. FERC Factor §292.304[e][2][v].* QFs should have a "best efforts" obligation to deliver their contract capacity to the utility during system emergencies, defined as a period when the integrity of the utility's

system is threatened. Exhibit Weyerhaeuser-ICNU/302 provides an example of a system emergency clause.

7. **Line Losses.** *Issue 1d. FERC Factor §292.304[e][4].* QFs reduce line losses if they are located closer to a load center than the avoided resource, and should receive a credit to their avoided cost price. Conversely, QFs that are located farther from a load center than the avoided resource increase line losses, and should receive a reduction in their avoided cost price. The utility should use the loss factors contained in the utility's OATT where line loss benefits or costs are clear-cut. The utility should perform QF-specific line loss studies if there is uncertainty concerning the impact of a large QF on the utility's line losses.

8. **Transmission System Impacts.** *Issue 1d. FERC Factor §292.304[e][4].* A QF's impact on the utility's transmission system will be identified in the interconnection studies for a particular QF project. QFs should be compensated in a negotiated contract if they reduce the need for new transmission or for reliability-must-run generation in the area in which they are located. Conversely, QFs may have to bear transmission costs as part of their interconnection charges if their location triggers the need for a transmission upgrade. Such transmission credits or costs should be dealt with through the negotiated power purchase contract or interconnection agreement for individual QFs, not in standard avoided cost rates. The utility's transmission studies should be based on transmission plans and load flow studies that recently have been reviewed and approved by state regulators or by a regional transmission organization. QF resources in aggregate can result in the deferral or avoidance of transmission upgrades, and large QFs should receive a pro rata share of any transmission savings to which they contribute.

9. **"Firmness" of QF power supply commitments.** *Issues 1b and 1c. FERC Factor §292.304[e][3].* QF power supply commitments should be reflected in the payment terms for QF contracts. Firm capacity QFs should be paid capacity payments based on their achieved capacity factor during peak periods, as discussed above under the Reliability guideline. As-available or non-firm QFs should receive capacity payments strictly on a $ per MWh basis for power delivered during peak periods.

10. **Avoided Costs Indexed to Natural Gas.** *FERC Factor §292.304[e][2][vi].* Large QFs should have available the same options and methods for indexing avoided costs to natural gas prices that are available to standard contract QFs, as approved in Order 05-584. As provided in Order No. 05-584 at 35, the choice of the gas indexing option should be the QF's.

11. **Diversity value.** *Issue 1d. FERC Factor §292.304[e][2][vii].* QF generation is more valuable than a large proxy plant due to the aggregate value of the smaller size, shorter lead times, and diversity of QF resources. This should be reflected in the opportunity for QFs to earn additional capacity payments for performance

superior to that of the avoided resource, as discussed above under the Reliability guideline.

12. **Natural gas price mitigation benefits.** *Issue 1d. FERC Factor §292.304[e][2][vi].* To the extent that a CHP project can demonstrate that it uses natural gas more efficiently than the proxy CCGT plant (to produce the CHP plant's electric output) plus a stand-alone boiler (to produce the CHP plant's useful thermal output), the CHP project should receive the same natural gas price mitigation value as a renewable generator that conserves an equal amount of natural gas.

13. **Simultaneous Purchase / Sale and Surplus Sale Options.** *Issues 8 and 9.* "Surplus sale" is defined as the QF's sale to the purchasing utility of the net output of the QF generation minus the QF host's on-site electricity requirements. "Simultaneous purchase and sale" means the QF's sale to the purchasing utility of the net output of the QF generation and the purchase of the QF host's on-site electricity requirements from the purchasing utility under that utility's applicable retail sales tariff. Under a "simultaneous purchase and sale" the QF and the purchasing utility enter into two separate transactions. Nothing in this guideline limits the ability of a QF to sell any electricity at wholesale to third parties.

    (1) QFs may either contract with the purchasing utility for a "surplus sale" or for a "simultaneous purchase and sale;" provided, however, that the QF's selection of either such contractual arrangement shall not be inconsistent with any retail tariff provision of the purchasing utility then in effect or any agreement between the QF and the purchasing utility;

    (2) The two sale/purchase arrangements described in paragraph (1) will be available to QFs regardless of whether they qualify for standard contracts and rates or non-standard contracts and rates, however the "simultaneous purchase and sale" is not available to QFs not directly connected to the purchasing utility's electrical system;

    (3) The negotiation parameters and guidelines should be the same for both sale/purchase arrangements described in paragraph (1); and

    (4) The avoided cost calculations by the utilities do not require adjustment solely as a result of the selection of one of the sale/purchase arrangements described in paragraph (1), rather than the other.

14. **Debt Imputation.** *Issue 13.* Debt imputation should not be considered in setting avoided cost rates for QFs of any size.

15. **Off-System QFs.** *Issue 14. FERC Rules §292.303[d].* Large QFs should have access to the same contract provisions concerning off-system QFs that are included in the standard, Commission approved off-system QF contract.