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April 7, 2006

***Via Electronic Filing and U.S. Mail***

Oregon Public Utility Commission  
Attention: Filing Center  
PO Box 2148  
Salem OR 97308-2148

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

Attention Filing Center:

Enclosed for filing in the above-captioned docket are the original and five copies of Portland General Electric's Phase II Rebuttal Testimony of Doug Kuns and Brett Sims (PGE/500). This document is being filed by electronic mail with the Filing Center.

An extra copy of this cover letter is enclosed. Please date stamp the extra copy and return it to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

JRG:am

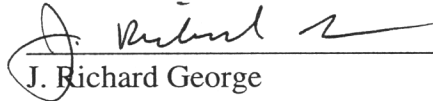
Enclosure

cc: UM 1129 Service List

## CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the PHASE II REBUTTAL TESTIMONY OF PORTLAND GENERAL ELECTRIC COMPANY to be served by electronic mail, and for those parties who have not waived paper service, by First Class US Mail, postage prepaid and properly addressed, upon each party on the attached service list, pursuant to Oregon Administrative Rule 860-013-0070.

Dated at Portland, Oregon, this 7<sup>th</sup> day of April, 2006.

  
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**BEFORE THE PUBLIC UTILITY COMMISSION  
OF THE STATE OF OREGON**

# **UM-1129 Phase II**

**PORTLAND GENERAL ELECTRIC COMPANY**

## **Investigation Relating to Electric Utility Purchases from Qualifying Facilities**

REBUTTAL TESTIMONY

OF

*Doug Kuns*  
*Brett Sims*

April 7, 2006

**BEFORE THE PUBLIC UTILITY COMMISSION  
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## **Table of Contents**

<b>I.</b>	<b>Introduction and Summary.....</b>	<b>1</b>
<b>II.</b>	<b>Non-standard QF Contracts.....</b>	<b>3</b>
<b>III.</b>	<b>Mechanical Availability Guarantee.....</b>	<b>10</b>



## **I. Introduction and Summary**

1   **Q. Please state your name and position.**

2   A. My name is Doug Kuns. I am employed by Portland General Electric Company as Manager  
3       of Pricing and Tariffs. I have previously presented testimony in this docket.

4       My name is Brett Sims. I am employed by Portland General Electric Company as Director,  
5       Origination, Structuring and Resource Planning. I have previously presented testimony in  
6       this docket.

7   **Q. What is the purpose of your rebuttal testimony?**

8   A. Our testimony addresses a limited number of issues raised in the February 27<sup>th</sup> Phase II  
9       testimony of Weyerhaeuser-ICNU and Staff regarding the development of non-standard QF  
10      power purchase contracts. These non-standard QF contracts generally apply to QF projects  
11      with nameplate ratings greater than 10 MW. In addition, we briefly discuss the Mechanical  
12      Availability Guarantee (MAG) proposal by Staff for the standard QF contract.

13   **Q. Please summarize your rebuttal testimony.**

14   A. Prior to discussing a few specific issues raised in direct testimony, we strongly support what  
15      we see as a common underlying objective in testimony of the parties that non-standard QF  
16      contracts:

- 17       • Be commercially reasonable with standard business practice terms and conditions  
18          consistent with the utility resource plans and with industry standards for power  
19          purchases.
- 20       • Must include pricing and terms and conditions that are based on the particular QF  
21          supply characteristics (including commitments to deliver) with avoided costs adjusted  
22          for the factors set out by the FERC in 18 CFR §292.304 (e).

1           These two requirements for non-standard QF contracts should be reinforced by the  
2           Commission to ensure benefits to utility customers from the mandated utility purchase of QF  
3           power.

4           We are concerned, however, that some of the recommendations in the Weyerhaeuser–  
5           ICNU/300 and Staff (Staff/1800, Schwartz) testimony diminish the importance of  
6           developing non-standard contracts (and standard contracts) that yield benefits to utility  
7           customers. We do not recommend an approach to contracts that minimizes the careful  
8           evaluation of QF project supply commitments in setting the power purchase contract terms.

9           The acquisition of QF power is not an academic exercise. When a QF resource is  
10          added to a resource portfolio, the new resource is built into the utility's supply portfolio for  
11          the duration of the contract. As a result, unexpected deviations in the availability of power  
12          from a supply resource exposes the utility and its customers to market price risk. The costs  
13          and characteristics of the supply are thus critically important to utilities and customers.

14          Our testimony discusses non-standard QF contract development with a focus on the  
15          objective to determine the specific value of power from each unique QF. We explain that a  
16          highly standardized contract or restricted contracting process will constrain the development  
17          of such valuation and may prevent economic and beneficial QF additions to the utility's  
18          supply portfolio.

## II. Non-standard QF Contracts

1 **Q. Is the EEI Master Agreement a reasonable template for non-standard QFs as proposed**  
2 **by Staff (Staff/1800, Schwartz/8, Lines 9 – 11)?**

3 A. Only to a limited degree. Staff suggests that the EEI Master Agreement is particularly  
4 applicable to “*negotiated*” QF contracts because these templates are typically used for  
5 transactions larger than 10 MW. However, the EEI Master Agreement, unaltered, is  
6 generally not suitable or utilized for wholesale energy transactions involving specific  
7 resources where the production or delivery characteristics do not meet the definitions of  
8 standard electric commodity products. We agree that the EEI Master Agreement may be  
9 helpful as a guide, but when the QF is proposing to deliver power with commitments  
10 different than the standard wholesale power products offered under an EEI Master  
11 Agreement (such as a fixed quantity of power delivered over a set period of time with  
12 standard credit requirements and damages provisions), the pricing and contractual template  
13 will need to be adjusted to reflect the specific QF project characteristics. These changes  
14 could be substantial and include changes to address risks, in particular different pricing,  
15 default, credit and damages provisions. Therefore, we do not recommend that the EEI  
16 Master Agreement be a required template, but rather only a reference for non-standard QF  
17 contracts.

18 Using the EEI Master Agreement as a reference point is consistent with the practice  
19 of utilities and energy producers in the development of bi-lateral agreements tied to specific  
20 resources that recognize these resources unique project characteristics. At the same time, we  
21 support the use of the EEI Master Agreement’s credit principles, adjusted for specific  
22 differences in transaction and counterparty credit risk.

1 **Q. Do you agree with Staff (Staff/1800, Schwartz/8, Lines 6-8) that some factors**  
2 **considered in adjusting avoided costs (in 18 CFR § 292.304 (e)) are best handled**  
3 **through contract provisions?**

4 A. No, we do not agree that certain factors should only be addressed in contract provisions.  
5 Pricing and contractual provisions are not “either – or” conditions. A QF’s power sale price  
6 plus its obligations and commitments to deliver power (which are established in the contract  
7 provisions) are inextricably linked.

8 Ultimately, the power purchase contractual terms help determine the value of the  
9 power received. The core negotiating challenge is making the power purchase pricing  
10 consistent with the applicable avoided (or avoidable) costs, which in turn, reflect the impact  
11 the QF has on the utility’s supply portfolio and operations. Therefore, flexibility in non-  
12 standard contracts is necessary to accurately reflect the avoided cost-based pricing for the  
13 QF power.

14 To the extent that the quality, production or delivery characteristics of the QF differ  
15 from those assumed for the avoided resource, then the only way to accurately reconcile  
16 those differences is to develop contract terms that either:

- 17 • Assure that the QF matches the attributes of the avoided cost resource in all material  
18 respects, or
- 19 • Value such resource differences in the contract price by adjusting the avoided costs.

20 In many cases altering contract terms and conditions to ensure that the quality and  
21 characteristics of the QF resource closely match those of the avoided cost resource is not  
22 possible as it no longer allows the parties to recognize the unique capabilities or limitations  
23 of the QF project.

1           The result of the contract development process should yield a non-standard QF  
2           contract that reflects the economic costs that are avoided as a result of the QF project's  
3           commitments to deliver power. Importantly, the parties to a non-standard contract and the  
4           Commission should be able to support the contract relative to the PURPA standards.

5   **Q. Do you agree with Weyerhaeuser-ICNU testimony (Weyerhaeuser-ICNU/300,**  
6   **Beach/10) that large QFs face significant utility barriers to developing non-standard**  
7   **QF contracts?**

8   A. No. We are concerned that Mr. Beach's testimony asserts that larger QFs must have  
9   significant assistance in the form of "standardized" non-standard QF contract provisions to  
10   overcome barriers to reaching power purchase arrangements with the utility under PURPA.  
11   We believe the testimony does not accurately represent the utility's willingness and  
12   understanding of its obligation to negotiate an appropriate PURPA contract. "Appropriate"  
13   means that the QF contract is consistent in pricing and contractual terms with alternative  
14   power supply options.

15           We see no value in "frustrating" the development of economic QF projects as  
16   asserted by Mr. Beach, and to imply that utility-created barriers are an impediment to  
17   appropriate QF development is misleading. The purchasing utility is not responsible to  
18   make every QF an economic investment for its owners. Instead, the utility must ensure that  
19   utility customers pay no more than the value of the power delivered from the QF. Of course,  
20   the Commission must play an important role in balancing the interests of QFs with those of  
21   the utility's customers. To this end, the Commission should reinforce the following non-  
22   standard QF contract negotiating parameters:

- 23           • The FERC avoided cost adjustment factors are relevant and must be applied to each

1 non-standard contract.

- 2 • The pricing must reflect the value of the specific QF project's power supply
- 3 characteristics consistent with its legally enforceable obligation.
- 4 • Unique QF project characteristics or contractual requirements will influence the
- 5 value, risk and pricing.
- 6 • The adjusted avoided cost prices and default terms must appropriately reflect risks.

7 **Q. Do you agree with the negotiation process outlined by Mr. Beach (Weyerhaeuser –**  
8 **ICNU/300, Beach/23)?**

9 A. No. We see the proposed process to be one-sided and not conducive to achieving full  
10 development of accurate pricing and related contractual terms. Mr. Beach states that a  
11 utility should state in writing why there is any deviation from the standard avoided costs and  
12 provide a quantitative basis for the adjustment. Practically, this is unwieldy and does not  
13 recognize the dynamic nature of a bi-lateral negotiation. As terms and conditions are  
14 defined and amended during a contract development process which recognizes the attributes  
15 of the project or circumstances of the QF, these changes often will influence the value and  
16 risk. Accordingly, if a written explanation and analysis were required for each material  
17 change in a term or condition, the efficient development of a contract would be impeded.  
18 We do not agree that the process proposed is helpful.

19 A more helpful requirement to assist a QF and utility in the development of an  
20 agreement would be to have a resulting non-standard QF contract approved by the OPUC.  
21 An approval process will ensure that the parties work to develop an agreement that is  
22 appropriate given the utility's avoided costs and the QF's delivery commitments.  
23 Additionally, without OPUC oversight, a utility may be subjected to criticism if an

1 agreement is not reached with a potential QF. Similarly, criticism is possible for contracts  
2 that could be perceived as too favorable to a QF.

3 **Q. Should the Commission adopt the recommendation by Weyerhaeuser-ICNU to index**  
4 **avoided costs to natural gas prices?**

5 A. No. We do not support a requirement to index avoided costs to natural gas prices, but  
6 believe an index may be appropriate if the non-standard QF contract reflects adjustments to  
7 avoided costs based on applying the FERC adjustment factors. Mr. Beach states,  
8 “Weyerhaeuser and ICNU support the indexing of electric market-based avoided costs to  
9 gas, because electric market prices in the West are strongly correlated with natural gas  
10 prices.” (Weyerhaeuser-ICNU/300, Beach/25) The Weyerhaeuser-ICNU recommendation  
11 again illustrates the critical importance of applying the FERC-defined factors to the QF  
12 supply characteristics in order to set the proper avoided cost pricing terms and conditions.  
13 For example, Mr. Beach does not seem to link the indexing proposal to QF dispatchability.  
14 If a large QF’s avoided cost pricing was indexed to natural gas, but the QF was not  
15 dispatchable, the utility could not economically increase or decrease the QF’s production in  
16 response to both electricity and gas prices as would be the case with a dispatchable utility  
17 plant. The utility would incur uneconomic costs. Staff has identified similar issues with gas  
18 indexing for large QFs. (Staff/1900, Chriss/9). We also recognize that a dispatchable QF  
19 may require additional pricing arrangements such as fixed capacity payments in order to  
20 accurately reflect avoided costs.

21 The “strongly correlated” relationship between electricity prices and natural gas  
22 prices is not as strong as implied by Mr. Beach. The correlation breaks down substantially  
23 on a seasonal basis and due to hydro conditions. The correlation tends to deteriorate during

1 the spring and early summer or even become negative as Northwest power prices respond to  
2 increased hydro production while natural gas prices are strongly influenced by national gas  
3 prices. We think it is important to acknowledge that customers will not benefit when  
4 indexed avoided costs induce generation by a QF when the price of gas is higher than the  
5 prevailing electricity market price, as can happen in a year with normal or above normal  
6 hydroelectric production.

7 **Q. What do you consider the most important parameter to support successful non-**  
8 **standard QF contract development?**

9 A. We have concluded that the most important parameter is flexibility in developing a non-  
10 standard QF contract. Flexibility in contracting ensures that the specific economic value of  
11 each QF's power deliveries are recognized with appropriate avoided cost pricing.

12 Mr. Beach similarly identifies this central need and challenge in non-standard QF  
13 contract negotiations when he discusses the use of competitive bidding solicitations to  
14 establish pricing for QFs. Mr. Beach states, "The challenge with solicitations is whether the  
15 utility's bid conditions will recognize and accommodate the unique needs of QFs, such as  
16 the need for CHP projects to satisfy the requirements of their thermal hosts."  
17 (Weyerhaeuser-ICNU, Beach/30)

18 Mr. Beach is clear that for successful QF development to occur, the utility purchaser  
19 must "accommodate the unique needs of QFs" in non-standard QF contracts. The  
20 implication is that without accommodations, a QF may not be developed. Further, Mr.  
21 Beach's statement illuminates the point that each unique QF represents a different power  
22 supply product with attributes that are distinct from those that are generally available in the  
23 wholesale energy market and different from what a utility's more standard resource



1 expansion plan may call for.

2           The Commission should encourage and support a non-standard QF contracting  
3 process that allows the utility and QF to recognize these unique issues and develop an  
4 economic addition to the utility's supply mix. The Commission should reject as  
5 unnecessary and potentially harmful, demands that non-standard QF contracts become more  
6 standardized and ignore the unique power supply characteristics of QFs.

### **III. Mechanical Availability Guarantee**

1   **Q. Do you support Staff's recommendation (Staff/1800, Scharz/29, Lines 5 – 6) to require**  
2       **a MAG for wind and run of river QFs in the standard QF contract?**

3   A. For standard contracts, we recommend that utilities not be required to use a MAG for  
4       intermittent resources such as wind and run of river QFs, in lieu of the Minimum Net Output  
5       provision (as included in our current standard contract).

6           A MAG and a Minimum Net Output specification generally seek to achieve the same  
7       result – identifying a minimum standard to which the QF must operate. Both require that  
8       operational assumptions be made about plant operations and certain (though different) data  
9       be tracked. For example, the Minimum Net Output tracks actual kWh production while the  
10      MAG tracks plant availability. A Minimum Net Output specification provides a standard  
11      that the QF will produce power from the chosen site; the MAG tests that the QF is capable  
12      of producing power. Over time, neither provision will produce more or less power for a  
13      particular site because the only way a standard contract QF maximizes revenues is to  
14      maximize kWh output, but the Minimum Net Output provides a quantitative measure of  
15      expected minimum production. We thus recommend retaining our Minimum Net Output  
16      provision.

17   **Q. Does this conclude your testimony?**

18   A. Yes.