

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PACIFIC POWER & LIGHT COMPANY, a  
division of PacifiCorp,

Respondent.

DOCKET UE-144160

**INITIAL BRIEF ON BEHALF OF COMMISSION STAFF**

September 11, 2015

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## I. INTRODUCTION

3 This docket concerns the Schedule 37 tariff of Pacific Power & Light Company (“PacifiCorp” or the “Company”), which contains standard offer rates available to cogeneration and small power producing facilities (known as qualifying facilities or “QFs”) with a nameplate capacity of 2 megawatts (“MW”) or fewer. The Schedule 37 tariff in effect protects the Company’s interest of minimizing QF costs, but has failed to encourage QF development. PacifiCorp seeks to tip the balance even further in its favor by reducing the rate available in its standard offer to these small qualifying facilities.

4 PacifiCorp seeks to reduce the rate by changing the method used by the Washington Utilities and Transportation Commission (“Commission”) to determine the costs that the Company avoids when it purchases QF power. Specifically, PacifiCorp seeks to eliminate payments to QFs for capacity that are based on the costs of a thermal generator because the Company’s Integrated Resource Plan (“IRP”) does not call for construction of another thermal resource in the next ten years.<sup>1</sup> If eliminated, the Company would purchase QF power at a rate that equals its projection for the market price of wholesale power. PacifiCorp’s proposal would suppress the rate for QF power, and thus further discourage QF development in its Washington service territory. The Commission should reject PacifiCorp’s proposal.

5 PacifiCorp’s proposal also contradicts the Public Utilities Regulatory Policies Act of 1978 (“PURPA”). Congress enacted PURPA to encourage the development of QFs.<sup>2</sup> The federal scheme dictates that electric utilities, like PacifiCorp, must purchase power generated by QFs at the utility’s “*full avoided cost*” — that is, the cost that the utility avoids by not having to

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<sup>1</sup> Declaration of Brian S. Dickman ¶ 4.

<sup>2</sup> *FERC v. Mississippi*, 456 U.S. 742, 751 (1982).

generate power itself or purchase power from another source.<sup>3</sup> PacifiCorp's proposal fails to capture its full avoided cost because the Company's estimated cost of market purchases does not account for the significant risk that it will not be able to purchase the amount of power it needs at the price it predicts. The Company avoids this market risk when it purchases QF power instead of power on the wholesale market. Accordingly, the Company's full avoided cost rate should include the value of avoided market risk.

6 To more accurately capture the Company's full avoided cost, Commission staff ("Staff") proposes that PacifiCorp calculate its avoided cost of capacity using the same methodology that the Commission recently adopted for calculating incremental cost in the context of renewable portfolio standard reporting. The incremental cost methodology is a vetted approach developed to address a common issue: to determine the cost that a utility would have incurred but for a regulatory requirement to purchase a different generation resource.<sup>4</sup> Staff's proposal more accurately captures PacifiCorp's full avoided cost by basing its calculation of avoided capacity costs on the lowest-cost resource identified in the Company's most recent IRP. Staff's proposal represents an 8.8 percent increase to the avoided cost rate when compared to the Company's current tariff, and an 18.4 percent increase when compared to the Company's proposal.

7 Consistent with federal law, Staff's proposal strikes an appropriate balance between encouraging QF development and ensuring that customers do not bear costs above the service costs the Company would otherwise incur. The Commission should adopt Staff's proposal.

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<sup>3</sup> *Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 406 (1983); see also 16 U.S.C. §824a-3(b); 18 C.F.R. § 292.304(b); 18 C.F.R. § 292.101(b)(6).

<sup>4</sup> Declaration of Jeremy B. Twitchell ¶ 32.

## II. ISSUES

8 This case involves the following issues:

- Whether PacifiCorp already has sufficient capacity to meet its load service obligations for the next ten years.
- Whether PacifiCorp will purchase bulk power on the wholesale market within the next ten years to meet its load service obligations.
- Whether PacifiCorp knows, with legal certainty, the purchase price of the bulk power it plans to obtain on the wholesale market.
- Whether the purchase of QF power enables PacifiCorp to avoid market risk costs associated with its heavy reliance on future market purchases of bulk power to meet its load service obligations.
- Whether PacifiCorp's projected price for wholesale energy fully captures the market risk costs that the Company avoids by purchasing QF power instead of power on the wholesale market.
- Whether Staff's proposal reasonably accounts for the aggregate capacity costs associated with market risk that the Company avoids through the purchase of QF power.

## III. ARGUMENT

### 1. **PURPA Requires PacifiCorp to Purchase QF Power at Its "Full Avoided Cost"**

9 Congress enacted PURPA to encourage the development of cogeneration and small power production facilities (known as qualifying facilities or QFs) by creating a market for the power they produce and by exempting them from certain state and federal laws governing

electric utilities.<sup>5</sup> PURPA requires utilities, like PacifiCorp, to purchase power produced by QFs at rates that: (1) are just and reasonable to electric customers; (2) do not discriminate against QFs; and (3) do not exceed the incremental cost to the utility of alternative electric energy.<sup>6</sup> By these terms, Congress intended to encourage QF production while preserving ratepayer indifference to the utility's purchase of QF power.<sup>7</sup>

10 Federal and state utility regulators execute PURPA jointly. Congress tasked the Federal Energy Regulatory Commission ("FERC") with promulgating rules "necessary to encourage [QF] power production," including rules requiring utilities to purchase electricity from QFs.<sup>8</sup> It afforded state utility commissions considerable discretion to implement FERC's rules, including the responsibility for determining the rate each utility must pay for QF power.<sup>9</sup>

11 In its rules, FERC opted to establish rates for QF power at the statutory ceiling. FERC recognized that allocating savings from QF production to the many customers of the utility would provide insignificant rate reductions to any individual customer; however, allocating these savings to the relatively small group of QFs could provide a significant incentive for greater development of these technologies.<sup>10</sup> FERC rules therefore require utilities to purchase QF power at rates that equal the utility's "full avoided cost" — that is, the cost the utility avoids by not having to generate itself or purchase electricity from another source.<sup>11</sup> The "full avoided

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<sup>5</sup> *FERC v. Mississippi*, 456 U.S. 742, 751 (1982); 16 U.S.C. § 824a-3(a), (e).

<sup>6</sup> 16 U.S.C. § 824a-3(b).

<sup>7</sup> *Southern Cal. Edison Co., et al.*, 71 FERC ¶ 61,269, 62,080 (1995) ("[Congress intended] to make ratepayers indifferent as to whether the utility used more traditional sources of power or the newly-encouraged alternatives").

<sup>8</sup> 16 U.S.C. § 824a-3(a).

<sup>9</sup> 16 U.S.C. § 824a-3(f); *FERC v. Miss.*, 456 U.S. at 751; see also *Indep. Energy Producers Ass'n, Inc. v. Cal. Pub. Utils. Comm'n*, 36 F.3d 848, 856 (9th Cir. 1994) (PURPA delegates to the states "broad authority" to implement its QF provisions).

<sup>10</sup> *Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policy Act of 1978*, Order No. 69, 45 Fed. Reg. 12,214, 12222 (Feb. 25, 1980) ("FERC Order No. 69"); See also FERC Order No. 69 at 12225-6).

<sup>11</sup> *Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 406 (1983) ("[FERC regulation], 18 CFR § 292.304(b)(2), requires a utility to purchase electricity from a qualifying facility at a rate equal to the utility's full



cost” standard provides maximum incentive for QF development while still ensuring that neither utilities nor their customers subsidize QF development by incurring QF costs that exceed the utility’s own service costs.

12 Under FERC rules, the full avoided cost must account for the value of both the energy costs and the capacity costs that the utility avoids by purchasing QF power. Energy costs are the variable costs associated with the production of electric energy (kilowatt-hours); they primarily represent the cost of fuel, operation, and maintenance expenses.<sup>12</sup> Capacity costs are the fixed costs associated with the capability to deliver the electric energy; they primarily represent the capital cost of the facilities.<sup>13</sup> Under the full avoided cost standard, rates for QF power must include a value for capacity, unless the purchasing utility can demonstrate that it does not need capacity over its ten-year planning horizon.<sup>14</sup>

13 Congress assigned to state utility commissions the nebulous task of determining the full avoided cost of each utility subject to its jurisdiction.<sup>15</sup> Full avoided cost rates are impossible to calculate with precision because they depend on numerous data, assumptions, estimates, and calculations. FERC’s rules provide a list of factors for state regulators to consider in determining a utility’s avoided cost.<sup>16</sup> An issue basic to many of these factors is the recognition of the

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avoided cost. The utility’s full avoided cost is ‘the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source.’ PURPA § 210(d), 16 U. S. C. § 824a-3(d). See 18 CFR § 292.101(b)(6) (the term full ‘avoided costs’ used in the regulations is the equivalent of the term ‘incremental cost of alternative electric energy’ used in § 210(d) of PURPA.)”.

<sup>12</sup> Robert E. Burns & Kenneth Rose, PURPA Title II Compliance Manual 33 (Mar. 2014); *see also* FERC Order No. 69 at 12225.

<sup>13</sup> *Id.*

<sup>14</sup> *See* 18 C.F.R. § 292.304; *see also* FERC Order No. 69 at 12225-6.

<sup>15</sup> 16 U.S.C. § 824a-3(e).

<sup>16</sup> 18 C.F.R. § 292.304(e).

capacity value of QFs.<sup>17</sup> In practical application, state utility commissions have a “wide degree of latitude” to determine avoided cost rates.<sup>18</sup>

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FERC rules also require that each utility make available a standard offer of full avoided cost rates to QFs with a design capacity of 100 kilowatts or less.<sup>19</sup> Standard offers are intended to facilitate the ability of very small QFs to sell to utilities by reducing the transaction costs associated with determining individualized avoided cost rates.<sup>20</sup> Realizing that standard offers can significantly encourage QF development, FERC provided state utility commissions with the authority to raise the design capacity cap and to establish the term of standard offers at their discretion.<sup>21</sup>

## 2. PacifiCorp’s Standard Offer Protects Customer Indifference to the Purchase of QF Power, but Has Failed to Encourage QF Development

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PacifiCorp testified that PURPA “mandates” customer indifference to its purchase of QF power.<sup>22</sup> The Company conflates the policy aspiration underlying the law — that customers do not subsidize QF development — with the legal standard for assessing whether rates for the purchase of QF power are lawful.<sup>23</sup> The Commission should remain wary of overlooking this distinction. Federal law requires that rates for QF power are set at PacifiCorp’s *full avoided cost*, not at rates that ensure customer indifference.<sup>24</sup>

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<sup>17</sup> FERC Order No. 69 at 12225.

<sup>18</sup> *In re Cal. Pub. Utils. Comm’n*, 133 FERC ¶ 61059, 2010 FERC LEXIS 1886; *Am. Paper Inst., Inc. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 416 (1983); *Indep. Energy Producers Ass’n, Inc. v. Cal. Pub. Utils. Comm’n*, 36 F.3d at 856 (9th Cir. 1994) (PURPA delegates to the states “broad authority” to implement its QF provisions).

<sup>19</sup> 18 C.F.R. § 292.304(c)(1).

<sup>20</sup> FERC Order No. 69 at 12223.

<sup>21</sup> *Id.*; 18 C.F.R. § 292.304(c).

<sup>22</sup> Declaration of Brian S. Dickman ¶ 6 (“In order to maintain the ratepayer indifference objective mandated by the Public Utility Regulatory Policies Act of 1978, deferred capacity costs must be included in avoided costs in a manner consistent with the Company’s resource procurement plans identified in its IRP.”).

<sup>23</sup> Rebuttal Declaration of Brian S. Dickman ¶ 9 (“Including a thermal resource capacity adder on top of the price of avoided market transactions would over-compensate QFs and would squarely conflict with PURPA’s ‘customer indifference’ standard.”); *see also* ¶¶ 11, 21, 29.

<sup>24</sup> 16 U.S.C. § 824a-3(b); 18 C.F.R. §§ 292.101(b)(6), .304 (emphasis added).

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Customer indifference is achieved when rates for QF power accurately reflect the Company's full avoided cost. Commission rules require PacifiCorp to update its standard offer rates annually, which supports the policy aspiration of customer indifference.<sup>25</sup> This update accounts for changes in market and system conditions and helps ensure the most current avoided cost price information applies to new QF contracts. Moreover, PacifiCorp's standard offer is available only to QFs having a design capacity of up to 2 MW, and fixed rates are available only for a period of five years.<sup>26</sup> As Staff witness Mr. Twitchell explained, "Washington's use of a five-year term for the standard offer tariff benefits the Company and ratepayers by ensuring that avoided cost rates accurately reflect current market conditions."<sup>27</sup> PacifiCorp acknowledged that such practices are "consistent with customer indifference."<sup>28</sup>

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The Company's standard offer, however, is not available to QFs that exceed the 2 MW design capacity limit. Instead, these larger projects must negotiate their rates and terms with PacifiCorp.<sup>29</sup> The standard offer provides a starting point for these negotiations.<sup>30</sup> It is critical therefore that PacifiCorp's standard offer accurately account for the Company's full avoided cost because failure to do so would place these larger QF developers in a disadvantaged negotiating position.<sup>31</sup>

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The terms of PacifiCorp's standard offer protect customer indifference, but have failed to encourage QF development. Only three QFs, with a combined design capacity of approximately

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<sup>25</sup> WAC 480-107-055.

<sup>26</sup> Declaration of Brian S. Dickman ¶ 4.

<sup>27</sup> Declaration of Jeremy B. Twitchell ¶ 40.

<sup>28</sup> Rebuttal Declaration of Brian S. Dickman ¶ 21.

<sup>29</sup> Declaration of Jeremy B. Twitchell ¶ 39.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

4 MW, are located in the Company's Washington service territory.<sup>32</sup> All three take advantage of PacifiCorp's standard offer. Two of these QFs went into service in 1986, the other in 2006.<sup>33</sup> No new QFs are under development.<sup>34</sup> In contrast, PacifiCorp has 138 QFs, representing approximately 1,728 MW of installed capacity, either operating or under development in its remaining jurisdictions.<sup>35</sup> The lack of QF development in PacifiCorp's Washington service territory indicates that the Company's standard offer does not provide adequate certainty to QF developers to finance new projects, and that developers have been unable to negotiate for more favorable terms with the Company.<sup>36</sup>

### **3. PacifiCorp's Proposed Change to the Commission's Avoided Cost Methodology Fails to Capture the Company's Full Avoided Cost**

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PacifiCorp's full avoided cost rate properly includes values for both its avoided energy costs and its avoided capacity costs. FERC Order No. 69 established that full avoided costs rates properly include a value for capacity whenever the QF reduces the utility's need to purchase power on the wholesale market:

If [a QF] demonstrates a degree of reliability that would permit the utility to defer or avoid construction of a generating unit or the purchase of firm power from another utility, then the rate for such purchase should be based on the avoidance of both energy and capacity costs.<sup>37</sup>

FERC recognized, however, that determining avoided capacity costs is "an extremely difficult exercise . . . based on estimation and forecasting of future occurrences."<sup>38</sup> Therefore, FERC determined that it will consider a method for calculating the value of capacity satisfactory to the

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<sup>32</sup> Unopposed Joint Motion to Admit Evidence, Exhibit 1: Redacted list of qualifying facilities on PacifiCorp's system (May 7, 2015) (On May 12, 2015, Order 03 granted the Unopposed Joint Motion to Admit Evidence).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> See Declaration of Jeremy B. Twitchell ¶ 40.

<sup>37</sup> FERC Order No. 69 at 12225.

<sup>38</sup> *Id.* at 12226.

extent that it “reasonably accounts for the utility’s avoided costs, and does not fail to provide the required encouragement of cogeneration and small power production.”<sup>39</sup> PacifiCorp’s proposed method for calculating its full avoided cost does not “reasonably account” for the capacity costs it avoids by purchasing QF power.

20 In this docket, PacifiCorp proposes to eliminate the capacity payments made to QFs. Specifically, PacifiCorp proposes to *only* make capacity payments based on the fixed costs of a combined cycle combustion turbine when its IRP calls for a new thermal resource to be constructed within the next ten years.<sup>40</sup> The Company’s proposal is a departure from the current practice of calculating its avoided capacity costs based on a simple cycle combustion turbine, but prorating the unit’s costs down to just 25 percent on the assumption that the Company only incurs capacity costs to meet its needs during the three peak months of the year.<sup>41</sup>

21 By eliminating its capacity payments, the Company’s proposal would limit its full avoided cost rate to its cost for energy, which equals its projection of the market price for wholesale power. The Company calculates its avoided energy cost by running two iterations of its Generation and Regulation Initiative Decision (“GRID”) model: one with its system as it is, and another with a generic QF resource that generates 50 average MW — the difference in cost between the two portfolios is the Company’s avoided cost for energy.<sup>42</sup> PacifiCorp testified that avoided market transactions constituted over 99 percent of the difference in the two portfolios.<sup>43</sup> Thus, PacifiCorp’s avoided cost for energy essentially equals its projection of market price.

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<sup>39</sup> *Id.* (emphasis added).

<sup>40</sup> Declaration of Brian S. Dickman ¶ 7.

<sup>41</sup> *Id.* at ¶ 10.

<sup>42</sup> Declaration of Jeremy B. Twitchell ¶¶ 22-23; *see also* Declaration of Brian S. Dickman ¶¶ 12, 7.

<sup>43</sup> Declaration of Brian S. Dickman ¶ 12.

The Company's projection of the market price, however, fails to "reasonably account" for the capacity costs that it avoids by purchasing QF power because it does not account for market risk — e.g., the significant risk that the Company will not be able to acquire the quantity of power it needs at the price it anticipates. In fact, PacifiCorp has significantly less capacity than it needs to meet system demand.<sup>44</sup> Although the capacity acquisition strategy presented in the Company's 2015 IRP does not call for a new Company-built thermal resource until 2028, it does call for the annual acquisition of significant amounts of capacity from market resources, which the Company calls front office transactions ("FOTs").<sup>45</sup> The Company defines FOTs as "proxy resources, assumed to be firm, that represent procurement activity made on an on-going basis *to help the Company cover short positions.*"<sup>46</sup> Importantly, "*FOT prices are determined at the time of the transition*, usually via an exchange or third party broker, and are based on the then-current forward market price of power."<sup>47</sup> According to its 2013 IRP Update, the Company will require over 1,400 MW in FOTs in 2026, the last year before it builds a new major thermal resource, to meet system demand.<sup>48</sup>

In the ten-year period from 2015 to 2024, the Company's IRP calls for an average annual procurement of 843 MW of capacity from FOTs.<sup>49</sup> For comparison, PacifiCorp's average annual procurement of capacity from FOTs (843 MW) is virtually double the design capacity of the next thermal resource that the Company currently plans to put into service in 2028 (423 MW).<sup>50</sup> In

<sup>44</sup> Declaration of Jeremy B. Twitchell ¶ 16; *see also* Declaration of Brian S. Dickman ¶ 11.

<sup>45</sup> Declaration of Jeremy B. Twitchell ¶ 16.

<sup>46</sup> *Id.* at ¶ 17 (citing *In the Matter of PacifiCorp 2015 Integrated Resource Plan*, Docket UE-140546, PacifiCorp 2015 IRP, Volume I at 128 (emphasis added)).

<sup>47</sup> *In the Matter of PacifiCorp 2015 Integrated Resource Plan*, Docket UE-140546, PacifiCorp 2015 IRP, Volume I at 128 (emphasis added).

<sup>48</sup> Declaration of Brian S. Dickman ¶ 11.

<sup>49</sup> Declaration of Jeremy B. Twitchell ¶ 16 (citing *In the Matter of PacifiCorp 2015 Integrated Resource Plan*, Docket UE-140546, PacifiCorp 2015 IRP, Volume I at 196).

<sup>50</sup> *Id.*

other words, PacifiCorp is, on average, approximately two utility-scale power plants short of meeting its capacity needs every single year for the next ten years.

24 Critically, FOTs are not market purchases of bulk power that the Company has already acquired, they are purchases the Company *plans on making at some future date* to meet system demand.<sup>51</sup> As Staff testified, “Any QF that enters [PacifiCorp’s] system prior to a future market purchase will reduce the amount of capacity that the Company needs to acquire, and must be compensated appropriately for these avoided capacity costs.”<sup>52</sup>

25 PacifiCorp witness Mr. Dickman acknowledged that the Company’s IRP “identifies FOTs as necessary to address capacity shortfalls.”<sup>53</sup> Mr. Dickman further testified that he agrees that “a QF that enters PacifiCorp’s system will reduce the need for FOT purchases (which, in turn, address a capacity shortfall) during its five year term.”<sup>54</sup> Mr. Dickman, however, contends that avoided FOTs “represent the costs of *energy and capacity* that the Company will actually incur without the addition of a QF” and that therefore, QFs should not get any additional capacity payment based on the costs of a thermal resource.<sup>55</sup> Mr. Dickman is incorrect.

26 Again, PacifiCorp conflates two distinct concepts: its projection regarding the cost of FOTs and the cost that the Company will “actually incur.”<sup>56</sup> Mr. Dickman alleges that Staff “misapprehends the nature of FOT market purchases” because “FOTs are firm products” and thus, “the price of the seller’s capacity is embedded in the price of the market transaction.”<sup>57</sup> Mr. Dickman would be correct if the Company had already contracted for the firm delivery of bulk

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<sup>51</sup> *Id.* at ¶ 17; see also *In the Matter of PacifiCorp 2015 Integrated Resource Plan*, Docket UE-140546, PacifiCorp 2015 IRP, Volume I at 128.

<sup>52</sup> *Id.* at ¶ 19.

<sup>53</sup> Rebuttal Declaration of Brian S. Dickman ¶ 6.

<sup>54</sup> *Id.* at ¶ 9.

<sup>55</sup> *Id.* at ¶ 7.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at ¶ 8.

power to meet system demand, and thus knew, with legal certainty, the cost of the market transactions that QFs enable it to avoid. But, as long as the market transaction is merely anticipated, so too is the price.

27 FERC confirms that a utility's cost estimates for future market acquisitions are not a sufficient basis for establishing full avoided cost. FERC states:

If a [QF] contracts to deliver power . . . it may enable the purchasing utility to avoid entering into a bulk power purchase agreement with another utility. The rate for such a purchase should be based on the price at which such power *is purchased, or can expect to be purchased, based upon bona fide offers* from another utility.<sup>58</sup>

PacifiCorp does not know the purchase price of FOTs because it has not yet entered into the necessary power purchase agreements to meet its load nor has it obtained bona fide offers that establish the price at which it can expect to purchase such power.<sup>59</sup> Rather, the Company predicted the cost of its future purchases using its GRID model.<sup>60</sup> Unfortunately, the Company's GRID model is not a magic crystal ball that accurately predicts future costs.

28 PacifiCorp's market risk is pronounced given its heavy reliance on FOTs. The Company's projection of market price is based on many interrelated assumptions, including hydropower availability, unplanned generator outages, and changing demand throughout the Western U.S.<sup>61</sup> As Staff noted, "[U]nexpected variation in any one of these factors could create higher market prices, as the California energy crisis showed, which represents a significant risk to [the Company]."<sup>62</sup> Given the multitude of factors that could dramatically impact market price,

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<sup>58</sup> FERC Order No. 69 at 12226 (emphasis added).

<sup>59</sup> Declaration of Jeremy B. Twitchell ¶ 17; see also *In the Matter of PacifiCorp 2015 Integrated Resource Plan*, Docket UE-140546, PacifiCorp 2015 IRP, Volume I at 128.

<sup>60</sup> See Declaration of Jeremy B. Twitchell ¶ 19.

<sup>61</sup> *Id.* at ¶ 25.

<sup>62</sup> *Id.*



and the Company's heavy reliance on FOTs, avoiding market risk through the purchase of QF power provides material value to the Company.

29 PacifiCorp, however, attempts to minimize the capacity value that QFs provide to its system by testifying that fixed-price contracts for QF power: (1) create financial risk rather than mitigate risk, and (2) are not appropriate hedging mechanisms. To the first point, PacifiCorp argues that market prices are in a period of sustained decline, and thus, fixed price QF contracts expose the Company to risk by locking in a rate that does not decline with the market-rate.<sup>63</sup> The Company neglected to mention that market price also can rise. FERC understood that a utility's true avoided cost would stray from a rate fixed at the initiation of the contract between the utility and the QF; nevertheless, it found that Congress did not intend a "minute-by-minute evaluation of cost," and that, "in the long run, 'overestimations' and 'underestimations' of avoided costs would balance out."<sup>64</sup> As already noted, annual updates to the Company's full avoided cost rate and the limited five-year term of the standard offer in Washington help ensure avoided cost rates accurately reflect current market conditions, and thus do not stray far from the Company's true cost of service.

30 To the second point, PacifiCorp argues that fixed-price QF contracts are not appropriate hedging mechanisms because they do not have a predetermined quantity or time of delivery, only a predetermined price.<sup>65</sup> Here, the Company again overlooks the fact that FOTs are merely *anticipated purchases containing price estimates*, and therefore do not have a predetermined quantity, time of delivery, or price. Only after FOTs "[are] purchased, or can expect to be purchased, based upon bona fide offers from another utility" do they provide the Company with

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<sup>63</sup> Rebuttal Declaration of Brian S. Dickman ¶ 17.

<sup>64</sup> FERC Order No. 69 at 12224.

<sup>65</sup> Rebuttal Declaration of Brian S. Dickman ¶18.

a predetermined quantity, time of delivery, or price.<sup>66</sup> QFs mitigate the Company's exposure to market risk.

Of note, in the context of arguing that Washington customers should pay for out-of-state QF expenses, PacifiCorp testified in its 2014 general rate case that QFs contribute to its total system capacity needs and provide resource diversity benefits.<sup>67</sup> In particular, PacifiCorp argued that market prices do not reflect its actual avoided costs "because [market price] fails to account for the impact of a QF on the Company's existing resources or the QFs ability to defer future capacity additions."<sup>68</sup> The Company further argued that QFs, as emission-free resources, "may act as a hedge against future carbon regulation, the exact nature of which is currently unknown."<sup>69</sup> Moreover, the Company asserted, "QFs provide diversity to the Company's resource portfolio, which can act to reduce risk."<sup>70</sup> PacifiCorp's testimony in its last general rate case, does not support its position in this docket. Rather, it supports the position of Staff.

#### **4. Staff's Proposal Reasonably Accounts for PacifiCorp's Full Avoided Costs**

31 To more accurately capture the capacity value PacifiCorp avoids by purchasing QF power, Staff proposes to calculate the Company's full avoided cost using the same methodology that the Commission recently adopted for calculating incremental cost in the context of renewable portfolio standard ("RPS") reporting. The incremental cost methodology, codified in WAC 480-109-210, is ideally suited to calculating the Company's full avoided cost because it serves a common purpose: to determine the avoided costs that the Company would incur but for

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<sup>66</sup> See FERC Order No. 69 at 12226.

<sup>67</sup> *Wash. Utils & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-140762, Rebuttal Testimony of Gregory N. Duvall, Exh. No. GND-4T, at 14:19 - 19:26 (Nov. 14, 2014).

<sup>68</sup> *Id.* at 14:19 - 15:1.

<sup>69</sup> *Id.* at 18:1-2.

<sup>70</sup> *Id.* at 18:7-8.

the regulatory requirement to purchase power from a different source (a QF in this case, or a renewable resource in the case of the RPS).<sup>71</sup>

32 Specifically, Staff recommends that the Commission continue to establish PacifiCorp's avoided cost of *energy* using the Company's calculation.<sup>72</sup> The Company calculates its avoided energy cost by running two iterations of its GRID model: one with its system as it is, and another with a generic QF resource that generates 50 average MW — the difference in cost between the two portfolios is the Company's avoided cost for energy.<sup>73</sup> Staff next recommends that the Commission establish PacifiCorp's avoided cost of *capacity* using the incremental cost methodology codified in WAC 480-109-210(2)(a). The Company calculates its avoided capacity cost based on the lowest-cost capacity resource identified in its IRP most recently acknowledged by the Commission.<sup>74</sup> Staff proposes to include payments for capacity in the Company's full avoided cost rate whenever it has an avoidable capacity acquisition — whether a new thermal resource or market purchases of bulk power — within PURPA's ten-year planning horizon.<sup>75</sup>

Importantly, the incremental cost method was developed in consultation with numerous stakeholders, including representatives from PacifiCorp, and was ultimately supported by all parties involved.<sup>76</sup> Staff considers the incremental cost method appropriate for determining the avoided costs of capacity because of the consensus reached among stakeholders in developing the calculation, and because of the method's applicability to the avoided cost issue.<sup>77</sup> The

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<sup>71</sup> Declaration of Jeremy B. Twitchell ¶ 31.

<sup>72</sup> *Id.* at ¶ 35.

<sup>73</sup> *Id.* at ¶¶ 22-23; *See also* Declaration of Brian S. Dickman ¶¶ 12, 7.

<sup>74</sup> WAC 480-109-210(2)(a)(i)(e).

<sup>75</sup> Declaration of Jeremy B. Twitchell ¶ 36.

<sup>76</sup> *Id.* at ¶ 33.

<sup>77</sup> *Id.*

incremental cost methodology is a vetted, consensus approach to calculating the Company's avoided cost of capacity.

33 PacifiCorp, however, characterizes the incremental cost method as “simplified” and “inappropriate for determining the price paid to QFs.”<sup>78</sup> The crux of the Company's argument is, again, that QFs should not receive a capacity payment based on the cost of a thermal resource when the Company does not plan to build another thermal resource for more than ten years.<sup>79</sup> PacifiCorp's criticism is inapt because under Staff's proposal, the capacity payment represents avoided market risk, not deferred thermal plant investment. In particular, the capacity payment is necessary to capture the market risk inherent in the Company's heavy reliance on FOTs to meet system demand — a cost avoided when QF power displaces the need to purchase market power. Staff's proposal uses *the lowest-cost capacity resource identified in the Company's IRP* to “reasonably account” for the capacity costs that the Company avoids by purchasing QF power.

34 Staff's proposal is consistent with the “full avoided cost” standard. It represents an 8.8 percent increase when compared to the Company's current tariff, and an 18.4 percent increase to the avoided cost rate when compared to the Company's proposal.<sup>80</sup> Importantly, Staff's proposal strikes an appropriate balance between encouraging QF development and ensuring that customers do not bear costs above those that the Company would otherwise incur.

##### **5. PacifiCorp's Alternate Rate Design Would Further Discourage QF Development**

35 In testimony, PacifiCorp proposed an alternate rate design that was not part of its original filing. Consistent with rates currently in effect, the original filing provided a fixed rate for QF

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<sup>78</sup> Rebuttal Declaration of Brian S. Dickman ¶¶ 14-15.

<sup>79</sup> *Id.*

<sup>80</sup> Declaration of Jeremy B. Twitchell ¶ 39.

power regardless of the time of generation; the price reflects an annual average that includes periods of higher avoided costs (during times of peak demand) and lower avoided costs.<sup>81</sup> As an alternative to this flat fixed price, the Company proposes to revise its tariff to differentiate the energy payment into on- and off-peak periods, with prices during on-peak periods set higher to reflect the increased value of QF generation. The Commission should reject the Company's alternative rate design.

36 Staff opposes the Company's alternative rate design because it would further discourage QF development. As noted above, the five-year term for fixed rates in PacifiCorp's standard offer discourages QF development because it does not provide adequate revenue certainty to persuade QF developers to finance new projects.<sup>82</sup> Staff found, "Creating time differentiated QF rates would only subject developers to greater uncertainty and further discourage future QF development."<sup>83</sup> Staff also found that the Company's alternative rate design would disproportionately affect QFs by fuel type: on average, solar facilities would gain revenue, while wind and hydro facilities would lose revenue.<sup>84</sup> Staff recommends that the Commission reject the Company's alternative rate design to avoid discouraging QF development by creating greater cost recovery uncertainty for QF developers.

#### **6. PacifiCorp Should Include A Market Risk Premium in Its Next Avoided Cost Filing**

37 Staff recommends that the Commission order PacifiCorp to include a market risk premium in its next avoided cost filing. Quantifying the market risk that a utility faces, and could

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<sup>81</sup> Declaration of Brian S. Dickman ¶ 16.

<sup>82</sup> Declaration of Jeremy B. Twitchell ¶ 40.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

avoid by purchasing QF power, presented a challenge for Staff.<sup>85</sup> Staff found, however, that quantifying market risk is an important issue that affects the avoided cost calculations of all three of Washington's investor-owned electric utilities, and is one that all three utilities should address.<sup>86</sup> Staff therefore recommends that the Commission order PacifiCorp to propose a means for calculating a market risk premium in its next avoided cost filing.<sup>87</sup> The Commission's order would also serve as guidance to the state's other investor-owned utilities, who should proactively work to address market risk in their own avoided cost filings.

#### IV. CONCLUSION

38 PURPA requires PacifiCorp to purchase QF power at its full avoided cost. In this case, PacifiCorp and Staff agree that each QF that enters PacifiCorp's system will reduce the need for the Company to purchase FOTs, which, in turn, address a capacity shortfall.<sup>88</sup> PacifiCorp and Staff disagree, however, about how to appropriately capture the capacity costs inherent in the Company's reliance on FOTs, which it avoids through the purchase of QF power. According to FERC, a method for calculating the value of capacity from QFs satisfies the full avoided cost standard to the extent that it "reasonably accounts" for the utility's avoided capacity costs.

39 PacifiCorp's proposed change to the Commission's avoided cost methodology fails to "reasonably account" for the capacity costs that it avoids by purchasing QF power because it does not adequately account for market risk — e.g., the significant risk that the Company will not be able to acquire the quantity of power it needs at the price it anticipates. PacifiCorp's proposal therefore does not account for the Company's full avoided cost.

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<sup>85</sup> *Id.* at ¶ 30.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> Rebuttal Declaration of Brian S. Dickman ¶ 9.

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By contrast, Staff's proposal does "reasonably account" for PacifiCorp's avoided capacity costs by using the vetted, consensus approach of the incremental cost methodology. Staff's proposal captures the market risk costs inherent to the Company's heavy dependence on FOTs to service system demand based on the lowest-cost capacity resource identified in the Company's IRP. Staff's proposal therefore more accurately accounts for the Company's full avoided cost.

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PacifiCorp gripes that Staff's proposal could cause customers to pay for QF costs above the Company's true avoided cost. The Commission should take comfort in the fact that customer indifference is protected by the limited five-year term of the standard offer in Washington, which helps ensure avoided cost rates accurately reflect near-term market conditions.

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Staff's proposal in this proceeding is consistent with PURPA and FERC rules, and strikes an appropriate balance between encouraging QF development and ensuring that customers do not subsidize QF development. The Commission should adopt Staff's proposal.

Dated this 11<sup>th</sup> day of September 2015.

Respectfully submitted,

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