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STATE OF WASH. UTIL. AND TRANSP. COMMISSION

VIA FACSIMILE AND EXPRESS MAIL

Ms. Carole J. Washburn
Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Re: Notice of Opportunity to File Written Comments On Proposed Rules Related to Least Cost Planning for Electric Companies (Docket UE-030311) and Electric Company Purchases from Qualifying Facilities and Others (Docket UE-030423)

Dear Ms. Washburn:

This letter responds to the notice captioned above. It also responds to a request made by Commission Staff during an informal discussion of April 9 for additional information regarding the position of BP West Coast Products, LLC. ("BP"), on the rights of a Qualified Facility ("QF") under the Commission's rules for all-source competitive bidding by electric utilities. BP and TransCanada Pipelines, Inc., are currently developing a 720-MW cogeneration plant on BP land adjacent to BP's Cherry Point refinery, north of Bellingham. The refinery will consume all the plant's process-steam output and a portion of its electrical output. TransCanada has qualified the Cherry Point Project as a QF under the Public Utilities Regulatory Policies Act ("PURPA").

As requested, this letter first addresses the mandatory obligation of electric utilities under PURPA to purchase power from QFs. Next, we provide our reading of the Commission's existing rule on all-source bidding. We believe that the Commission's rule is consistent with PURPA, although certain specific PURPA requirements are not expressly stated in that rule. Lastly, we offer our comments on the Commission's inquiry about the necessity of proceeding with new rulemakings.

1. **The Mandatory Purchase Obligation Of Electric Utilities Under PURPA.**

Section 210(a) of PURPA, 16 U.S.C. §824a-3, requires that the Federal Energy Regulatory Commission ("FERC") prescribe rules to "require electric utilities to offer to (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities, and (2) purchase electric energy from such facilities." Section 3(4) of PURPA defines "electric utility" as "any person, State agency, or Federal agency, which sells electricity."

In PURPA, the Federal government uses state regulatory mechanisms to advance federal goals. PURPA expressly directed FERC, and not the states, to prescribe rules governing QF rates. Section 210(f) of PURPA gave the state regulatory commissions responsibility for implementing the statute in accordance with these FERC rules. *FERC v. Mississippi*, 456 U.S. 742 (1982); *Independent Energy Producers Association v. California Public Utilities Commission*, 36 F.3d 848, 856 (9th Cir. 1994). FERC has made it clear that state commission implementation must be consistent with the statute and with FERC's regulations.[1]

FERC issued its rules in its Order No. 69 in 1980.[2] FERC summarized the relevant part of these rules as follows:

> These rules provide that electric utilities must purchase electric energy and capacity made available by qualifying cogenerators and small power producers at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy or capacity from other suppliers.[3]

In another part of Order No. 69, FERC explained:

> Section 210(a) of PURPA provides that the Commission prescribe rules requiring electric utilities to offer to purchase electric energy from qualifying facilities. The Commission interprets this provision to impose on electric utilities an obligation to purchase all electric energy and capacity made available from qualifying facilities with which the electric

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[1] *Southern California Edison Company*, 70 FERC ¶61,215 at 61,677-78 (1995); *LG&E-Westmoreland Hopewell*, 62 FERC 61,098 at 61,712 (1993); *American REF-FUEL Company of Hempstead*, 47 FERC ¶61,161 (1989).

[2] 45 Fed. Reg. 12214, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶30,128 (1980), *order on reh'g*, Order No. 69-A, 45 Fed. Reg. 33958, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶30,160 (1980), *aff'd in part and vacated in part*, *American Electric Power Service Corporation v. FERC*, 675 F.2d 1226 (D.C. Cir. 1982), *rev'd in part*, *American Paper Institute, Inc. v. American Electric Power Service Corporation*, 461 U.S. 402 (1983).

[3] *FERC Statutes and Regulations* ¶30,128 at p. 30,864.

> utility is directly or indirectly interconnected, except during periods described in §292.304(f) [certain operational conditions] or during system emergencies.[4]

FERC implemented this requirement through its regulations at 18 C.F.R. § 292.303(a), which provides:

> **Electric utility obligations under this subpart.** (a) *Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with §292.304, any energy and capacity which is made available from a qualifying facility:
>
> (1) Directly to the electric utility; or
>
> (2) Indirectly to the electric utility in accordance with paragraph (d) of this section.

The reference to §292.304 in the quoted regulation is to 18 C.F.R. §292.304, which sets forth the avoided-cost rate that the electric utility must pay to QFs in satisfaction of its purchase obligation.

There are only three possible exceptions to an electric utility's "must purchase" obligation under FERC regulations. The first is during a system emergency.[5] The second is when an electric utility gives notice and can verify that "due to operational circumstances," purchases from QFs would cost more than the utility generating power itself.[6] FERC explained in Order No 69 that this was intended as a narrow exception that applied temporarily during light loading conditions when the costs for ramping up and down base load units would cost more than had the utility not purchased from the QF.[7] The third exception is when a state regulatory commission (or a non-regulated electric utility) applies for and receives a waiver from the PURPA obligations pursuant to 18 C.F.R. § 292.402. That section provides that such a waiver will be granted only if the applicant demonstrates that compliance is "not necessary to encourage cogeneration and small power production."

FERC recently made clear that a waiver under §292.402 is rarely granted and not easy to obtain. When Texas restructured its electric industry into generation companies, transmission and distribution companies, and retail service companies, there was an issue of whether any of these entities continued to have a PURPA "must purchase" obligation. FERC granted a requested declaratory order by QFs "that any company which meets the PURPA definition of electric

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[4] *Id.* at p. 30,870.

[5] 18 C.F.R. §292.307(b).

[6] 18 C.F.R. §292.304(f).

[7] *FERC Statutes and Regulations* ¶30,128 at p. 30,886.

utility following restructuring has a purchase obligation as set forth in 18 C.F.R. §292.303."[8] At the same time, FERC denied a request by the Texas Commission to waive the purchase obligation for all utilities in Texas. The Texas Commission argued that in a retail competition environment, it was not necessary to have additional protections to encourage QFs. FERC disagreed, finding that retail competition alone did not ensure that a sufficient market for QF power would exist, and that Texas could adopt a more market oriented way to determine avoided costs. FERC noted that other states had implemented retail competition without the necessity to waive the mandatory purchase obligation. FERC also noted that it had only granted a waiver in "certain limited circumstances."[9]

In sum, unless the Commission applies for and receives a FERC waiver from application of FERC regulations, then each Washington electric utility is legally obligated under PURPA to purchase the power offered by a QF. The Commission has the authority to determine the "avoided cost" rate that the QF must be paid, but it does not have the authority to relieve electric utilities in the State from their statutory purchase obligation under PURPA.

2. <u>The Commission's Rules Regarding Least Cost Planning And All Source Bidding Should Be Construed Consistent with PURPA.</u>

After PURPA was enacted, state commissions initially determined the avoided cost for jurisdictional electric utilities administratively, through hypothetical calculation of the long-term cost of new coal-or gas-fired resources that each utility would otherwise have built to satisfy its incremental need for power resources. Oftentimes, data used in these hypothetical calculations were speculative, particularly before the maturation of transparent natural gas and electricity supply markets. In hindsight, some judgment calls about costs look questionable. The Commission had its own problems with PURPA implementation in the resource acquisitions of Puget Sound Power & Light Company that culminated in a prudence-review proceeding. This experience led the Commission in 1993 to promulgate a system of rules whereby electric utilities would periodically identify, and then satisfy, their resource needs.

The process is biannual, beginning with the preparation of least cost plans by each jurisdictional electric utility. Under WAC 480-100-251, electric utilities must forecast long-term resource needs and identify the integrated mix of new supplies and conservation measures by which those needs could be satisfied at the lowest cost to the utility and its customers. Each least cost plan must include the implementation steps by which it would act on the plan to satisfy its resource needs.

When a utility identifies a need for resources in its least cost plan, WAC 480-107-001, *et seq.*, then obligates that utility to conduct an all-source bid through a request for proposals for new resources. The utility must allow bidding by QFs, independent power producers and

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[8] *Cogen Lyondell, Inc.*, 95 FERC ¶61,243 at 61,837 (2001).

[9] *Id.* at 61,838 and n. 3.

conservation providers. In this context, it is important to note that QFs include not only cogenerators, but also wind-power and other renewable energy resources fitting the FERC definition of "small power production facility." 18 C.F.R. §292.204. Under WAC 480-107-005(16), the term "qualifying facilities" is linked by definition to FERC's PURPA regulations.

The Commission adopted these competitive-bidding rules in furtherance of its statutory obligations under PURPA:

> The Commission adopted competitive bidding procedures to implement the provisions of the Public Utilities Regulatory Policies Act of 1978 (PURPA) and FERC regulations pertaining to sales and purchases of power by electric utilities from qualifying small power producers or qualifying cogenerators. Through bidding, payment by electric utilities to these qualifying facilities (QFs) of "avoided costs" is established through a "market" process, rather than an administrative one. WAC 480-107-060 requires each electric utility to file a request for proposals (RFP) every two years, within 90 days of filing its IRP.

The Commission thusly described its rules in its Notice of Termination of Notice of Inquiry (Docket UE-940932 (April 22, 1998)). It also stated in the same document:

> As a means of implementing PURPA, the Commission established the bidding rule as a preferred forum for avoided cost determination, replacing what was previously known as administratively-determined avoided costs. The Commission's intent in establishing a market test for determining these avoided costs was to generate bids between PURPA developers that were lower than the administratively-determined costs, and to allow the utilities to purchase only the supply of resources needed. ...as long as PURPA requirements remain in place, the Commission believes this approach is preferable to the administrative method when new resources are being acquired.

The low bid in the competitive bidding process becomes the soliciting utility's market-determined "avoided cost" price to which QFs are entitled under PURPA. FERC regulations, 18 C.F.R. Part 292, and WAC 480-107-005 define avoided cost as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from a qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." The Commission's approach to avoided-cost determination is consistent with FERC regulations, which allow state commissions the discretion to determine avoided-cost rates "administratively," i.e., through hypothetical estimates of the power or resource costs, or through competitive bidding:

> Whether the State regulatory authority determines avoided cost administratively, through competitive solicitation (bidding), or some

> combination thereof, it must in its process reflect prices available from all sources able to sell to the utility whose avoided cost is being determined.

Southern California Edison Company, 70 FERC ¶61,215 at 61,677 (1995). "All sources" means "all technologies and all potential types of sellers (QFs and non-QFs)." *Southern California Edison Company*, 71 FERC ¶61,269 at 62,078.

Commission regulations provide three ways in which a QF may exercise its statutory right to sell power to the electric utility conducting all-source, competitive bid for resources. WAC 480-107-120(1) specifies the following purchase obligations of electric utilities to QFs:

> Each electric utility's obligation to purchase from qualifying facilities shall be limited to one of the following:
>
> (a) Energy and capacity from projects under long-run contract A pursuant to the solicitation and bidding process described in these rules;
>
> (b) Energy or capacity offered at any time under long-run prototype contract B from qualifying facilities with a design capacity of one megawatt or less; or
>
> (c) Energy offered under the short-run prototype contract.

WAC 480-107-010 requires electric utilities to develop each of the three types of prototype contracts (A, B and C) and attach them to the RFP that initiates the competitive bidding process. Prototype contracts A and C track the pricing alternatives that each QF may elect under 18 C.F.R. §292.304. Prototype B is an administratively simplified contract available only to QFs with capacity of one MW or less. Such a small QF is entitled to a Prototype B contract at any time, even without competitive bidding.

Nothing in the Commission's regulations would necessarily entitle any bidder, other than a QF, to a contract at the end of a competitive bidding process as a matter of federal law. Power marketers, other utilities and non-QF independent producers might not be awarded power-supply contracts by the soliciting utility. However, QFs are legally different under PURPA, FERC regulations, and the Commission regulations discussed in this letter. At the end of the bidding, each QF has the right to either a Prototype A or Prototype C power-supply contract (or Prototype B for QFs of 1 MW or less) at the utility's market-determined avoided cost up to the full amount of the resource need identified in that utility's least cost plan.

Similarly, nothing in the Commission's regulations would necessarily prohibit an electric utility from building or acquiring its own power resource as a ratebase asset, so long as that action were consistent with the rights of QFs under PURPA. Thus, an electric utility could build, rather than purchase from a power marketer, other utility, or a non-QF independent producer. Of course, if the build option were more costly than the purchase option, the utility would face a

regulatory disallowance and write-off of the difference. Again, however, QFs are legally different under PURPA. Utilities interested in a build option still have an overriding legal obligation to purchase from cogenerators, wind-power developers and other QFs under one of the three prototype contracts specified in Commission regulations.

3. **Comments On The Commission's Inquiry About The Necessity Of Proceeding With One Or More New Rulemakings.**

BP believes that our reading of Commission regulations is consistent both with PURPA and with the intent of the Commission. We do not believe that any new rulemaking is necessary to clarify the existing rights of QFs, such as the Cherry Point Cogeneration Project, to a supply contract with each utility having an identified resource need. Further clarification of QF rights under Commission regulations may be advisable, but not necessary in our view.

Very truly yours,

Davis Wright Tremaine LLP

John A. Cameron

JAC:smp