Agenda Date: February 12, 2015
Item Number: A1

Docket: **UE-144160**
Company: Pacific Power & Light Company

Staff: Jeremy Twitchell, Regulatory Analyst
Dave Gomez, Assistant Power Supply Manager

Recommendation

Issue a Complaint and Order Suspending the Tariff Revisions filed by Pacific Power & Light Company on December 29, 2014.

Background

WAC 480-107-055(1) requires investor-owned utilities to make an annual filing of their avoided capacity and energy costs. On December 29, 2014, Pacific Power & Light Company (Pacific Power or company) filed tariff sheets with the Washington Utilities and Transportation Commission (commission) to update its avoided cost tariff, Schedule 37, with an effective date of January 29, 2015. At the request of commission staff (staff), the company subsequently extended the effective date to January 30, 2015, and then February 13, 2015, to allow staff and the company more time to discuss the issues raised by the filing.

The avoided costs set forth in Schedule 37 are the standard offer rates that the company pays to small qualifying facilities (two megawatts or fewer) pursuant to the Public Utilities Regulation and Policy Act (PURPA), which requires utilities to purchase the output of small generation facilities at the utility's avoided cost – the amount the utility would have paid to acquire the same amount of capacity and energy from the resource it would have selected in the absence of the qualifying facility. WAC 480-107-055(2) states that a utility's avoided cost should be based on the most recent proposals received pursuant to a request for proposals, cost estimates included in the utility's current integrated resource plan, the results of the utility's most recent bidding process, and current projections of market prices for power.

Discussion

Pacific Power's filing makes two significant changes to Schedule 37. The first is to change the way the company pays qualifying facilities for their capacity component and the second is to impose integration costs on wind and solar qualifying facilities. In reviewing this filing, staff also identified inconsistencies among the three investor-owned utilities in how they determine their avoided costs.

Capacity Component

In previous avoided cost tariffs, Pacific Power offered a two-part rate that paid for capacity and energy separately. The capacity component was based on the cost of an equivalent amount of capacity provided by a combined cycle combustion turbine (CCCT). The company offered capacity payments regardless of whether its integrated resource plan (IRP) in effect at the time called for a CCCT within the 10-year period covered by the tariff. For example, the company's 2013 filing offered capacity payments for the period from 2014-2023 based on a combined cycle combustion turbine, even though the 2013 IRP did not project a need for a CCCT until 2024.

In the current filing, Pacific Power proposes to cease paying capacity payments that are based on the cost of a CCCT because the company's 2013 IRP Update does not project a need for a CCCT until 2027,[1] and the tariff only covers the period from 2015 to 2024. The 2013 IRP Update projects that the company's load growth prior to 2027 can be met with energy efficiency, small solar, combined heat and power, and firm energy purchases from market resources, which the company calls front-office transactions. Front-office transactions account for the vast majority of the company's forecasted acquisitions; in 2016, for example, the IRP Update projects that the company will acquire about 700 MW in front-office transactions and about 110 MW from other resources.[2]

Since market transactions are the company's selected resource and the resource that it most recently acquired through a request for proposals, the company calculated its avoided cost solely based on the projected cost of the front office transactions that it plans to acquire and which would be reduced by the addition of a qualifying facility. The company determined these costs in its GRID software program, which forecasts regional market prices. Since front office transactions are for firm energy, the company's position is that GRID's projected costs implicitly include a capacity value, and therefore the avoided cost rates that GRID determined reflect an implicit capacity payment. The proposed rates would be paid solely on an energy basis, with that implicit capacity payment included in each megawatt-hour.

Staff understands the company's point, but does not agree that market rates provide an accurate proxy for capacity value. Market rates reflect a plant's marginal cost of production, which by definition does not include the fixed costs associated with the plant's ability to provide capacity. An avoided cost rate that is based on projected market prices, therefore, would only capture the energy component of the avoided cost, and would not include the value of the capacity that a qualifying facility provides to Pacific Power's system. This would result in an understated avoided cost rate that would be discriminatory to qualifying facilities. While PURPA allows for energy and capacity avoided costs to be expressed on an energy (cents per kilowatt-hour) basis, it

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[1] PacifiCorp 2013 IRP Update, page 54.
[2] *Id.*

explicitly requires that they be calculated separately.[3] An avoided cost rate calculated on energy costs and an assumed, implicit capacity cost does not, in staff's opinion, provide sufficient transparency or accuracy in the capacity component of the avoided cost.

This is consistent with the commission's proposed rule in the Energy Independence Act rulemaking (UE-131723). Staff has previously argued that the utilities' practice of using market energy prices as the baseline against which they calculated the incremental cost of their renewable resources failed to account for the capacity value of the renewable resource, which resulted in incomplete calculations.[4] The commission's proposed rule addressed this concern by instituting a uniform methodology for incremental cost calculations that, if adopted, would require utilities to calculate energy and capacity costs separately and include them in the total. Staff believes that the incremental cost calculation, which asks a utility to compare the renewable resource purchase to what it would have otherwise acquired, is fundamentally the same as the avoided cost calculation, which asks a utility to compare the qualified facility purchase to what it would have otherwise acquired. The logic applied in the proposed rule grew out of the commission's avoided cost rule, which individually identifies energy and capacity as necessary components of the avoided cost.[5]

Integration charge

The company's filing also would, for the first time, reduce the payment that it makes to wind and solar qualifying facilities based on the company's modeling of the costs that it incurs to integrate wind resources into its system. The company proposes to reduce the payment that it makes to wind facilities by $3.06 per megawatt-hour (MWh) and the payment to solar facilities by $0.77 per MWh. These amounts are based on the company's 2014 Wind Integration Study.

Staff questions whether a study that evaluated the cost of integrating hundreds of megawatts of wind across the company's six-state service territory can reasonably be applied to a two-megawatt facility. Staff is not convinced that a facility of two megawatts or fewer would have a noticeable impact on the company's costs. Staff also notes that the Wind Integration Study did not actually model the costs of solar integration on the company's system, but rather discounted the wind integration cost by 75 percent based on industry practice.[6] Staff does not believe that this is a rigorous enough approach to support a reduced payment for solar qualifying facilities.

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[3] 16 U.S.C. § 292.302(b)
[4] *In the Matter of Evaluating Electric Utility Renewable Portfolio Standard Reports Under the Energy Independence Act*, Dockets UE-131056, UE-131063, and UE-131072, "Staff Comments of the Washington Utilities and Transportation Commission," (July 1, 2013), page 12.
[5] WAC 480-107-055(1).
[6] Per company materials and presentation at the Sept. 26, 2014, meeting of the 2015 IRP Advisory Group.

Furthermore, given that Washington employs the West Control Area methodology for allocating costs, and that the company's avoided costs are calculated on that basis, it may be problematic to accept the conclusions of a wind integration study that included the company's six-state territory. Staff believes that integration costs on the west side of the system, where hydropower is generally the flexible resource that is used for variable resource integration, may be less expensive than integration costs on the east side of the system, which generally uses natural gas and coal facilities for integration.

The Wind Integration Study was conducted to inform the company's assumptions in the planning process, and while it has proven a useful tool for that purpose, staff does not believe that it has enough granularity to justify the establishment of rates for small qualifying facilities.

Other issues for consideration

In analyzing this filing, staff compared it to the avoided cost tariffs from the other utilities and found several differences among them, from the size of facilities covered by the standard offer to the inclusion of balancing charges to the rates themselves. For example, PSE's avoided cost rate for 2015 is 75 percent higher than Pacific Power's proposed 2015 rate, and Avista's is 41 percent higher. While staff would expect some differences in the utilities' avoided cost rates given their different system characteristics and embedded costs, the wide differences that have resulted seem to be driven more by differences in how the rates are calculated.

Staff believes that the issues presented in this filing require more careful consideration, particularly in light of their potential to further exacerbate the differences among the utilities' avoided cost rates and send conflicting signals to potential developers of qualifying facilities, particularly renewable facilities.

Conclusion

The commission should issue an order as described in the recommendation section.