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VIA ELECTRONIC FILING

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Re: Docket U-161024—Pacific Power & Light Company's Comments on Proposed Rules

On February 20, 2019, after reviewing comments from stakeholders on three sets of draft proposed rules, the Washington Utilities & Transportation Commission (Commission) filed a Notice of Proposed Rulemaking (CR-102) with the Office of the Code Reviser regarding rules governing Washington's implementation of the Public Utility Regulatory Policies Act of 1978 (PURPA). On February 22, 2019, the Commission issued a Notice of Opportunity to File Written Comments on Proposed Rules (Notice). With that notice, the Commission provided its proposed rules (Proposed Rules). In response to the Commission's Notice, Pacific Power & Light Company (Pacific Power), a division of PacifiCorp, submits these written comments.

Pacific Power actively participated in the stakeholder comment process that preceded the issuance of the Proposed Rules, and, while many of Pacific Power's concerns were addressed through that process, several of Pacific Power's concerns have not been addressed. The Commission's PURPA rules must be guided by the principle of customer indifference, which requires that "ratepayers and utilities should remain indifferent to whether power is purchased from qualifying facilities or from other sources."[1] The Proposed Rules identify this principle at Section 480-106-050(1), stating at subsection (a) that rates must be just and reasonable to the utility's customers, and at subsection (c) that rates must not exceed the utility's avoided costs. Other sections of the rules, however, do not go far enough to ensure the customer indifference standard is met. Pacific Power provides comments on specific sections of the Proposed Rules with the primary aim of recommending changes that are consistent with customer indifference.

Proposed Rule 480-106-040(1):

480-106-040(1) requires utilities to annually file a schedule of their estimated avoided costs that identifies the avoided costs of energy and costs of capacity, both in combined form and separately. Pacific Power has concerns with a static requirement to file avoided capacity costs separately from energy costs. A requirement to break avoided capacity costs out from combined capacity and energy costs seems simple on its face, but is, in fact, problematic.

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[1] *Washington Utilities and Transportation Commission v. Washington Water Power Company*, 83 P.U.R.4th 364 at 375 (1987).

First, Pacific Power's concerns relate to the fact that for qualifying facilities (QF) energy and capacity cannot be procured separately because PURPA imposes a "must take" obligation on utilities: all energy produced by a QF must be purchased at avoided cost rates. If a QF defers incremental utility capacity the must purchase obligation means that it will also be providing energy. This means that in the QF context energy and capacity are always linked, so separating these values will not provide QFs meaningful information on which to decide whether to move forward with development of the facility or not. A second issue arises from the fact that a QF is entitled to receive the value of capacity to the extent it will defer a utility capacity resource of the same type, but, depending on the design of a given utility's tariff, requiring separate capacity values may make such filings overly complex. This is especially so, given that such separate data is unlikely to be used by QFs in their decision making. The final rules should provide the Commission flexibility, rather than tying its hands in a way that may prevent, frustrate or overcomplicate these update filings. Pacific Power proposes language that reserves Commission discretion so that it can require or not require a separate breakout of capacity costs based on the circumstances. Pacific Power proposes the Proposed Rules be revised as follows:

> (1) **Filing requirement.** A utility must file by November 1st of each year, as a revision to its tariff described in WAC 480-106-030 Tariff for purchases from qualifying facilities, a schedule of estimated avoided costs that includes ~~identifies, both separately and combined,~~ its avoided cost of energy and its avoided cost of capacity<u>, either combined or as specified by the commission</u>. All schedules of estimated avoided costs must include:

Proposed Rule 480-106-040(1)(b):

1. <u>Filed Versus Acknowledged IRPs</u>

480-106-040(1)(b) would require utilities to identify the cost of avoided capacity based on the fixed costs of the next planned capacity addition that is identified in the utility's most recently *acknowledged* integrated resource plan (IRP). However, in subsection (i) of the Proposed Rules, a utility is required to identify the projected fixed costs of its next planned capacity addition using the estimates in its most recently *filed* IRP, or based on the most recent project proposals received in a Rule 480-107 compliant request for proposals (RFP). Subsection (ii) then reverts back to the use of the utility's most recently *acknowledged* IRP with regard to market purchases for capacity.

Before adopting final rules, the Commission should correct this inconsistency, and adopt the use of information from the most recently *filed* IRP throughout. For purposes of setting avoided cost rates, using the most up-to-date information is critical and a filed IRP will have more up-to-date information than an acknowledged IRP. If the avoided costs data is not updated until the IRP is acknowledged, then the Commission may be ignoring newer, more accurate information on which to base avoided costs, only on the basis that the utility's IRP has not been acknowledged. Ignoring the most current information is inconsistent with customer indifference and Proposed Rules, Section 480-106-050(1), and could work against customers and QFs alike with costs that are either too high or too low.

In a rate case, new data and updated information is often incorporated into the Commission's determination, with the goal of ensuring that customers receive the most accurate possible rates. There is no reason to treat a utility's filed IRP that enables a more accurate calculation of avoided costs any differently when these costs that are ultimately paid by customers through their rates. Accordingly, Pacific Power offers modifications to the Proposed Rules at Section 5 below that will allow a utility to base these costs on its *filed* IRP.

2. <u>Net Capacity Costs, Not Fixed, Meets Customer Indifference.</u>

Both 480-106-040(1)(b) and 480-106-040(1)(b)(ii) require utilities to set their avoided costs of capacity at the fixed costs of the next incremental capacity resource. Using fixed costs overstates the value of that capacity because it fails to account for the lost benefits of a deferred capacity resource. Net capacity costs accounts for both the costs *and* the benefits of deferred capacity resources, and is the only way to ensure customers remain indifferent to QF capacity payments. An example that demonstrates why it is appropriate to consider deferred capacity benefits when determining avoided costs is that QFs cannot be economically dispatched. Non-QF utility resources are typically subject to "merit order dispatch" based on their economic value in a given settlement interval, and such resources also typically contribute to operating reserves. Under PURPA, a utility has an obligation to take all of the power a QF generates, and therefore QFs are not subject to dispatch based on economic merit. This "must purchase" obligation means that the utility must forego dispatching other more economic resources in a given settlement interval and purchase the QF's power even if it is not the most economic choice. The ability to economically dispatch is therefore a value that QFs cannot provide.

As a simplified numerical example, if a utility-owned 1 MW resource costs $20/MWh to run, but the utility can dispatch other resources that cost $19/MWh, it would choose to save one dollar and dispatch those other resources. A QF that is also priced at $20/MWh cannot be turned down based on economics because of the "must purchase" obligation. If that QF displaces the $19MWh non-QF resource, then customers lose the opportunity to save one dollar in every hour throughout the entire 15-year contract term that the $19MWh resource would otherwise be dispatched. In other words, unless the full benefits of the ability to economically dispatch a deferred capacity resource are accounted for in the cost of capacity, customers are not indifferent when QF capacity displaces it. Other benefits that are displaced and not supplied by a QF, such as operating reserves or ancillary services, should similarly be accounted for. Pacific Power proposes replacing the word "fixed" with "net" in these sections of the Proposed Rules as set forth in Section 5 below, which will ensure a more accurate calculation of the true avoided cost of capacity that is then ultimately reflected in QF avoided cost pricing.

3. <u>Requiring the Use of a SCCT as a Proxy is Overly Specific Given Potential Changes in Policy and Technology.</u>

When utilities identify market purchase for capacity in their IRPs, 480-106-040(1)(b)(ii) requires them to use the projected fixed cost of a natural gas simple-cycle combustion turbine (SCCT) as a proxy for the avoided cost of that market capacity. However, use of a natural gas fueled generator as a proxy unit may be inconsistent with potential policy changes that would require

Washington to move away from the use of fossil fuels for electricity production. A move away from SCCTs may also be warranted by evolutions in technology, for instance the cost and performance of energy storage resources or other emerging technology.

Indeed, the Commission recently directed Pacific Power to include a supplement to its 2019 IRP that addresses potential changes in law. In light of the impact that new legislation may have on the types of resources that utilities can include in rates, Pacific Power requests the Commission reconsider whether it is appropriate to use a SCCT as the proxy resource. Memorializing a specific type of resource in the Commission's rules eliminates the ability of the rules to adapt to a changing environment and creates a risk that it may be difficult to determine accurate or relevant avoided costs. Other alternatives could allow utilities to value market capacity purchases based on what the utility would otherwise have to pay for capacity from a like resource (*e.g.*, solar or wind) in the market. One way to determine this market value would be to require utilities to provide evidence of what it would otherwise cost the utility to build that same type of resource to supply the needed capacity. Pacific Power's changes to 480-106-040(1)(b)(ii) are reflected in Section 5 below and address this concern.

4. <u>Levelized Pricing should be Subject to Security to Protect Customers.</u>

480-106-040(1)(b)(c) would allow QFs to receive levelized payments for the avoided cost of capacity that they expect to be paid over the term. To protect customers, this provision should require QFs to post security as a condition of receiving levelized pricing for both energy and capacity. Oregon does not allow levelized avoided cost prices because of the risk to customers. Utah and Wyoming do allow QFs to receive levelized prices but balance this risk to customers by requiring the QF to post levelized security upon reaching commercial operation[2]. This ensures that customers are not at risk if the QF defaults during the early years of operation when the utility is paying higher than avoided costs and then as the levelized price drops below the non-levelized avoided cost in the out years of the term, the security is returned to the QF. While QFs may claim that posting levelized security is a hindrance or burden to QF development, the large number of small and large QFs successfully operating in Utah and Wyoming under levelized prices that have posted security proves otherwise. This practice allows QF development while protecting customers. In prior comments to the Commission's draft rules, Pacific Power made clear that providing levelized prices amounts to the extension of credit to a QF, since prices nearly always deescalate over time. In the summary of comments the Commission provided with the Notice, it rejected Pacific Power's suggested addition of a provision allowing levelized pricing security. The Commission's reasoning was that "[t]he avoided cost rate provides sufficient incentives for long-term performance." If avoided costs prices are lower in the later years, then the incentives are actually the reverse.

Under normal circumstances, a non-levelized price escalates over time with lower prices at the beginning of the term and higher at the end. In other words, a QF that receives *non-levelized* prices is incentivized towards continued long-term performance so that it can reap the rewards of

[2] Currently, Utah and Wyoming have over 850 MW of operating QF contracts that receive levelized prices while posting levelization security.

higher pricing in the later years. On the other hand, levelization brings some of the benefits of higher, late-term pricing forward to the beginning of the term, thereby greatly diminishing a QF's long-term performance incentive. At the same time, customers who pay those higher prices in the early years of the contract when the actual avoided cost is lower, are effectively providing a loan to the QF. Payback of that "loan" requires continued performance in the later years of the contract to make up for the time period where customers are paying prices that are above a utility's actual avoided costs. Without security to ensure the QF's continued performance, there is an increased risk of a QF defaulting toward the end of the term. With levelized pricing a QF will have a greater incentive to default and take advantage of higher pricing from other sources if prices in the market exceed its levelized price, and this is exacerbated by levelized pricing because its payments will be lower than the utility's estimated avoided costs for such years. Allowing utilities to require levelized security protects customers against the risk of a QF reaping a windfall at the end of their contracts by defaulting and leaving customers without the payback that was expected. The Proposed Rules prevent utilities from requiring levelized pricing security, and thereby expose customers to unsecured and uncompensated risks. The Proposed Rules are therefore inconsistent with customer indifference.

Also, for the same reasons that Pacific Power stated above in its comments regarding separate energy and capacity pricing under 480-106-040(1), capacity should not be separately levelized. Instead QFs should have the option to choose one or the other, blending levelized capacity payments with non-levelized energy payments is unnecessarily complicated, when it is likely that most QFs would prefer levelized total payments. The edits to 480-106-040(1)(b) in Section 5 below address this concern, and the other concerns regarding levelized pricing discussed above.

5. <u>Pacific Power Edits to Proposed Rule Section 480-106-040(1)(b)</u>

(b) Identification of avoided capacity: An estimated avoided cost of capacity expressed in dollars per megawatt based on the projected <u>net</u> ~~fixed~~ cost of the next planned capacity addition identified in the succeeding ten years in the utility's most recently <u>filed</u> ~~acknowledged~~ integrated resource plan filed pursuant to WAC 480-100-238 Integrated re-source planning, and such identification must include the following:

(i) Identification of capacity cost: A utility must identify the projected <u>net</u> ~~fixed~~ costs of its next planned capacity addition based on either the estimates included in its most recently filed integrated resource plan or the most recent project proposals received pursuant to an RFP issued consistent with chapter 480-107 WAC, whichever is most current; and

(ii) Proxy for planned market purchases: If the utility's most recently <u>filed</u> ~~acknowledged~~ integrated resource plan identifies the need for capacity in the form of market purchases not yet executed, then the utility shall <u>value its avoided cost of such capacity based on the prevailing market cost it would otherwise incur to build the same type of resource to supply such capacity</u> ~~use the projected fixed~~

> ~~costs of a simple-cycle combustion turbine unit as identified in the integrated resource plan as the avoided capacity cost of the market purchases~~.

> (c) Levelized avoided cost pricing: ~~The~~ Subject to appropriate credit and security provisions, a qualifying facility may request an avoided cost price ~~of capacity must account for any differences between the in-service date of the qualifying facility and the date of the next planned generating unit by levelizing~~ that reflects the lump sum present value of the avoided costs over the contract term, ~~cost of capacity~~ discounted by the utility's commission-approved weighted aver-age cost of capital.

Proposed Rule 480-106-050(4)(a)(i):

480-106-050(4)(a)(i) sets the term of the standard rate contracts to 15 years, and dictates how far in advance a QF can contract with the utility under a standard rate contract. As to the latter, the Proposed Rules require a clarification. Based on the draft rules and stakeholder comments to those drafts, Pacific Power believes that the intent of the Proposed Rules is to provide an overall maximum term of 15 years, and to limit QFs to executing those contracts to no more than 3 years before their commercial operation dates. However, as written, the Proposed Rules would require standard rate prices be provided only starting 12 years after the QF reaches commercial operation. Pacific Power continues to be concerned that the three-year period will result in stale standard contract pricing that is inconsistent with its actual avoided costs to the detriment (depending on whether the prices are higher or lower than more current avoided costs) of either QFs or customers. Allowing standard contract pricing for a QF that far in advance of the commercial operation date is therefore inconsistent with customer indifference. Regardless of these concerns, the language should be corrected if the Commission decides, in final rules, to require utilities to provide pricing to QFs three years before a QF is able to provide power. Pacific Power's proposed revisions also clarify that the three-year period is not to be exceeded. Pacific Power proposes the following changes to the Proposed Rules to achieve what it believes was the Commission's intent in this subsection:

> (i) The utility's standard rates for purchases must offer fixed rates to a new qualifying facility for a term of fifteen years beginning on the date of contract execution, ~~but~~ and the date of contract execution must not be more than three years prior to ~~less than twelve years from~~ the commercial operation date of the qualifying facility.

Conclusion:

Pacific Power appreciates the opportunity to provide these comments on the Commission's Proposed Rules, and further appreciates the deliberative process it engaged in with stakeholders to develop them. Before adopting final rules, Pacific Power respectfully requests the Commission to continue to rely on the customer indifference standard in the avoided cost prices paid to QFs as its guiding principle, since it is the Washington utilities' customers that will bear these costs. Accordingly, Pacific Power respectfully requests that the Commission consider the changes to the Proposed Rules detailed in these comments.

Please direct any inquiries to Ariel Son, Regulatory Affairs Manager, at (503) 813-5410.

Sincerely,

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