BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PACIFICORP for Approval of an IRP-Based Avoided Cost Methodology For QF Projects Larger than One Megawatt	)))))	Docket No. 03-035-14

REBUTTAL TESTIMONY OF BRUCE N. WILLIAMS

May 6, 2004

1 **Q. Please state your name and business address.**

2 A. My name is Bruce Williams. My business address is 825 NE Multnomah, Suite
3 1900, Portland, Oregon 97232.

4 **Q. Are you the same Bruce Williams that filed direct testimony in this case?**

5 A. Yes.

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

7 A. The purpose of my testimony is to review and evaluate the recommendations of
8 Ms. Kelly Francone regarding the effect of a Power Purchase Agreement (PPA),
9 such as from a Qualifying Facility (QF) contract, on the credit capacity of the
10 utility. In addition, I also respond to that portion of the Direct Testimony of
11 Mr. Roger J. Swenson concerning the need to account for the debt impact of QF
12 contracts.

13 **Q. Do Ms. Francone and Mr. Swenson argue that QF power purchase contracts**
14 **that result in balance sheet liabilities will not impair the credit quality and**
15 **financial position of the utility?**

16 A. No. Their testimony is silent on this point. I believe the silence is an implicit
17 acknowledgment that power purchase contracts increase the debt ratio and
18 weaken the financial position of the utility when a contract is classed as a debt on
19 the balance sheet. No party claims that this balance sheet impact should be
20 ignored. Whether or not the fixed obligation of a QF contract is recognized as a
21 debt on the balance sheet or as debt equivalent (such as by rating agencies), that
22 obligation has a known and measurable cost that should be factored into PPA
23 analysis and, therefore, into QF avoided cost determination and contract pricing.

1 **Q. Have other utility commissions acknowledged that PPAs, including contracts**
2 **with QFs, increase the fixed cost burden on a utility?**
3 A. Yes. For example, the Florida Public Service Commission (FPSC) has addressed
4 this issue. Rule 25-22.081(7), F.A.C. requires utilities to address the cost impact
5 of power purchases on their capital structure: "If the generation addition is the
6 result of a purchased power agreement between an investor-owned utility and a
7 nonutility generator, the petition shall include a discussion of the potential for
8 increases or decreases in the utility's cost of capital…."
9 The FPSC specifically recognized the need to consider the financial costs
10 imposed on the utility by purchased power contracts in the pricing of QF power.
11 For example, the FPSC included an adjustment for the debt equivalent of
12 purchased power in the standard offer contract for Florida Power & Light
13 Company in Docket No. 990249-EG, and concluded that "[b]uying power
14 increases the utility's fixed charges, which, in turn, can reduce financial
15 flexibility. Standard & Poor's (S&P) notes that, 'regardless of whether a utility
16 buys or builds, adding capacity means incurring risk.' …In including this equity
17 adjustment FPL is reflecting the cost, in the form of less financial flexibility, that
18 is imposed on electric utilities with purchased power contracts." (*Order No. PSC-*
19 *99-1713-TRF-EG*, September 2, 1999 at 7-9).
20 **Q. Has the investment community recognized that there is a financial impact on**
21 **the utility associated with entering into PPA obligations, such as a QF**
22 **contract?**

1 A. Yes. As I noted in my direct testimony, irrespective of FASB pronouncements,
2 the investment community already views a portion of fixed charges under power
3 purchase agreements as a debt equivalent in their assessment of a utility's
4 financial position. For example, Standard & Poor's Corporation (S&P) clearly
5 views purchased power agreements as fixed obligations which are debt-like in
6 nature and will impute debt and interest when calculating financial ratios. With
7 respect to the credit implications of imputed debt, S&P concluded that, "Utilities
8 can offset these financial adjustments by recognizing purchased power as a debt
9 equivalent, and incorporating more common equity in their capital structures."
10 ("'Buy Versus Build': Debt Aspects of Purchased Power Agreements", *Project &*
11 *Infrastructure Finance*, October 2003.) Indeed, Ms. Francone granted that
12 "[r]ating agencies like Standard & Poor's have already been considering the
13 impact on cash flows and will continue to do so." (Kelly Francone Direct at 6.)
14 **Q. Have investors' concerns regarding the implications of potential off-balance-**
15 **sheet liabilities intensified in recent years?**
16 A. Yes. Investors' focus on the implications of off-balance-sheet obligations has
17 intensified in recent years. The collapse of Enron and other active market
18 participants and the subsequent fallout in wholesale energy markets galvanized
19 the attention of the investment community on the potential risks posed by
20 exposure to off-balance-sheet liabilities, leading to increased scrutiny. More than
21 was the case in past years, PPAs are recognized by the financial and accounting
22 community as debt or debt equivalents. That debt has a cost or a negative impact
23 on the financial position of the purchaser.

1 **Q. Do you agree that the costs associated with PPAs are immaterial?**

2 A. I disagree that an unstated materiality threshold should be the basis for ignoring a
3 cost when evaluating the price paid to QF generators. Power purchase agreements
4 that are classed as debt under GAAP or reflected as an off-balance-sheet liability
5 reduce the credit capacity of the utility. Reduction of credit capacity has a cost.
6 Costs should not be ignored until they become material. Failure to incorporate
7 this cost effectively allows the non-utility QF generator to shift an uncompensated
8 cost and a risk to utility customers that ultimately purchase the energy.

9 **Q. Should Utah "follow in the steps of the Oregon commission" and analyze**
10 **every new QF contract on a case-by-case to determine the impact that**
11 **contract has on the utility credit quality, as recommended by Ms. Francone?**

12 A. No. First, one of the primary objectives of this proceeding is to establish avoided
13 cost methodologies designed to minimize QF contract formation disputes, as
14 much as possible. As such, the point of this docket is to simplify standard
15 aspects of contracting with large QF generators as part of Tariff No. 38. Second,
16 the Oregon staff recommendation, made in the context of the Request for
17 Proposal (RFP) process, was to postpone considerations on the cost of a particular
18 power purchase agreement until a short list of proposals is prepared. The
19 Company was not prevented from considering the debt-related analysis in its
20 decision-making. Every QF is on the "short list." While the Company agrees that
21 each QF contract must be examined individually by Company accountants (since
22 the accounting determination is dependent on the actual contractual
23 terms/conditions), there is no reason to postpone or delay any part of the

1 evaluation of how to determine QF contract prices from a methodological basis.
2 We know today the pricing factors regarding QF contracts.

3 **Q. Did Mr. Swenson grant that any extra costs associated with the financial**
4 **impact of QF contracts should be considered?**

5 A. Yes. Mr. Swenson agreed that if the utility incurred extra costs then an
6 adjustment should be made to the extent the costs can be "demonstrated and
7 calculated." (Swenson Direct at 24.)

8 **Q. Have the conditions identified by Mr. Swenson been met?**

9 A. Absolutely. Investors recognize that the costs associated with the debt equivalent
10 of purchased power obligations are very real, because of the higher debt leverage
11 and attendant financial risks that they impose on a utility. In order to "maintain
12 ratepayer neutrality", these additional costs must be reflected in the payments to
13 QFs. Otherwise, ratepayers will ultimately bear the costs of increasing the
14 utility's investment risks and reducing its financial flexibility. Moreover, the
15 rating agencies have clearly acknowledged that such costs can be "demonstrated
16 and calculated", with S&P explicitly setting forth a framework to accomplish this
17 adjustment. As I noted earlier, regulators in other jurisdictions have also
18 approved procedures to quantify and recognize the costs associated with the
19 financial impact of purchased power.

20 **Q. Do you agree with Mr. Swenson that this is a new or uncertain issue**
21 **(Swenson Direct at 24)?**

22 A. No. Contrary to Mr. Swenson's portrayal, the financial impacts of purchased
23 power agreements have been recognized by the investment community since at

1 least the early 1990s. For example, Moody's Investors Service (Moody's)
2 recognized in 1990 that "all such contracts...imply a decrease in financial
3 flexibility" (Electric Utility Week, October 8, 1990 at 12) and outlined a detailed
4 quantitative assessment of the impact of purchased power in 1992 ("The Risks of
5 Purchased Power Can Impair Electric Utility Credit Quality", *CreditWeek*,
6 September 1992). While I would grant that investors' focus on off-balance-sheet
7 obligations has increased markedly in recent years, the real costs imposed by
8 purchased power obligations are not new or uncertain.

9 **Q. Is there any reason to ignore the financial impact of purchased power**
10 **contracts in pricing QF power?**

11 A. No. The financial costs that accompany the debt equivalent of purchased power
12 contracts – whether recorded under GAAP or reflected as an off-balance-sheet
13 liability – are real costs that a utility (and ultimately ratepayers) bears as a result
14 of entering into QF contracts.

15 **Q. Should the business dealings between PacifiCorp's parent company and**
16 **unregulated affiliates be considered in this case, as Mr. Swenson suggests**
17 **(Swenson Direct at 25)?**

18 A. No. There is no merit to the concerns raised by Mr. Swenson. Further, the
19 purpose of this proceeding is to determine an avoided cost methodology for large
20 QF contracts, which includes consideration of the financial costs such contracts
21 impose on the utility. Any concerns Mr. Swenson may have regarding the
22 relationship of PacifiCorp to other business entities are well beyond the scope of
23 this case, and irrelevant to the investment community's conclusion that purchased

1 power contracts impose financial costs on the purchasing utility through higher

2 debt leverage and associated investment risk.

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

4 A. Yes.