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	)	Docket No. 03-035-14
Projects Larger than 1 Megawatt	)	

REBUTTAL TESTIMONY OF WILLIAM E. AVERA

September 19, 2005

1 **Q. Are you the same William E. Avera that filed direct and rebuttal testimony in this**
2 **case?**
3 A. Yes.
4 **Q. What is the purpose of your surrebuttal testimony?**
5 A. I am responding to the rebuttal testimony submitted by Mr. Roger Swenson on behalf of
6 US Magnesium. At page 9, Mr. Swenson suggests that the debt equivalence is "unclear
7 and subjective" and that a cost that "may or may not be incurred" should not be
8 considered in avoided cost. He further suggests that equity be imputed when a qualified
9 facility (QF) provides "step-in rights" to a utility.
10 **Q. Does Mr. Swenson question whether a cost associated with direct debt due to capital**
11 **lease accounting should be recognized when calculating avoided costs?**
12 A. No. Neither Mr. Swenson—nor any other party to this docket that I am aware of—
13 question that (1) there are direct debt costs associated with purchase power agreements
14 (PPAs) that qualify for capital lease accounting and (2) such costs should be recognized
15 in avoided cost calculations.
16 **Q. Does Mr. Swenson acknowledge the reality of debt equivalence associated with QF**
17 **power purchase agreements?**
18 A. Yes. Although he admits being unclear on the issue, Mr. Swenson seems to acknowledge
19 that the utility may need to infuse additional capital to maintain the credit quality of the
20 utility.
21 **Q. Is the investment community "unclear and subjective" about the debt equivalence of**
22 **PPAs?**

23 A. Not at all. As I demonstrate in my Rebuttal Testimony, investors, bond rating agencies,
24 and the accounting profession regard debt equivalence in clear and objective terms. For
25 example, the recognized bond rating service Standard & Poor's has stated that it "views
26 electric utility purchased power agreements as debt-like in nature."[1] Nor is there any
27 mystery why this is so. PPAs impose an obligation for the utility to make future pay-
28 ments just like debt does. The higher the payment obligations of a utility, the more fi-
29 nancial risk the investors in its securities bear.

30 To offset the higher risk from QF PPAs, PacifiCorp will have to add equity to its
31 capital structure.[2] And since equity is more expensive than debt, customers will ultimate-
32 ly bear the higher cost of capital caused by the QF PPAs unless these higher costs are
33 considered in pricing QF power—as Dr. Powell and I have recommended. There is noth-
34 ing unclear, subjective, or uncertain about that.

35 **Q. Does Mr. Swenson's suggestion of attributing utility equity to "step-in rights" make**
36 **any sense?**

37 A. No. I am unaware of any circumstance in which credit rating agencies have imputed eq-
38 uity for contracts that allow step-in rights. Mr. Swenson appears to be confusing the con-
39 cept of debt equivalence with measures to limit adverse impacts upon customers due to
40 counterparty default. Step-in rights merely grant a buyer the right to take control of an
41 asset in the event the seller defaults. These rights typically take effect only when the
42 seller is in severe financial distress, like bankruptcy. Significantly, exercising step-in

[1] Standard & Poor's, *Utilities & Perspectives*, May 12, 2003.

[2] Standard & Poor's has stated, "Utilities can offset these financial adjustments [to credit ratios] by recognizing purchased power as a debt equivalent, and incorporating more common equity in their capital structure." Standard & Poor's, *Utilities & Perspectives*, May 12, 2003.

43 rights does not relieve the utility of debt-related payments. In any event, if the utility
44 "stepped-in" then the result would likely be a greater amount of debt at the utility, as the
45 project debt could become an explicit obligation of the utility rather than an imputed debt
46 equivalent. Indeed, since the amount of the imputed debt is reduced by the risk factor,
47 the debt could be greater after stepping in.

48 In this context, the only time step-in rights become relevant is when they permit
49 the buyer to take control of an asset to mitigate damages due to a seller's default. Even
50 then, the utility would have to make whatever payments are necessary to keep the plant
51 operating and satisfy the creditors. In short, contractual step-in rights are not the equiva-
52 lent of common equity and cannot mitigate debt equivalence.

53 **Q. Does this conclude your surrebuttal testimony in this case?**

54 A. Yes, it does.