State of Utah
DEPARTMENT OF COMMERCE
Committee of Consumer Services

To: The Public Service Commission of Utah

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Date: November 20, 2008

Subject: Power Purchase Agreements between PacifiCorp and (1)Tesoro Refining and Marketing Company, Docket No. 08-035-82 and (2) Kennecott Utah Copper Corporation, Docket No. 08-035-83.

Background

On October 14, 2008, Rocky Mountain Power (RMP or Company) filed separate applications with the Public Service Commission (Commission) requesting approval of Power Purchase Agreements (PPA) between the Company and (1)Tesoro Refining and Marketing Company (Tesoro) dated October 8, 2008 and (2) Kennecott Utah Copper Corporation (Kennecott) dated October 9, 2008. Given the similarities between these PPAs and the associated issues, the Committee provides its analysis and recommendations in a single memo.

Tesoro PPA

Tesoro operates as a qualifying facility (QF) under PURPA and is expected to deliver 15,833 MWh of non-firm energy per month to RMP. RMP proposes a one-year contract term ending December 31, 2009 and avoided cost energy prices differentiated based on delivery of power during on-peak and off-peak hours. Using the avoided cost methodology approved by the Commission in Docket No. 03-035-14, the Company proposes on-peak and off-peak avoided cost energy prices of $95.85/MWh and $42.34/MWh, respectively. The proposed prices were based on a GRID indicative avoided cost study performed by the Company on August 14, 2008. However, the GRID study did not include the Chehalis Plant. The prices do include a 2.93% avoided line loss adjustment (increase), which was determined using the approach attached to the proposed Tesoro PPA.

Kennecott PPA

Kennecott operates as a QF under PURPA and is expected to deliver approximately 14,000 MWh of non-firm energy per month to RMP. RMP proposes a one-year contract term ending December 31, 2009 and a flat avoided cost energy price of $76.96/MWh based on the methodology approved by the Commission in Docket No. 03-035-14. The proposed price is based on a GRID indicative avoided cost study performed by the Company on August 11, 2008. However, the GRID study did not include the Chehalis Plant. The price does include a 2.94% avoided line loss adjustment (increase), which was determined using the approach attached to the proposed Kennecott PPA.

Issues

The Committee considered two issues in connection with the proposed Tesoro and Kennecott PPAs:

(1) Whether the exclusion of the Chehalis Plant from the indicative price studies for Tesoro and Kennecott PPAs materially impacts the calculated avoided cost energy prices. The acquisition of Chehalis was approved by the Commission on August 1, 2008 and earlier included for cost recovery by the Company in its July 17, 2008 Utah rate case filing. These events occurred before the August dates when the indicative price studies were performed. Thus, the Company included the costs of the Chehalis Plant in the current Utah rate case filing, Docket No. 08-03538, but the resource was not included in calculating indicative prices for the Tesoro and Kennecott PPAs. This potentially violates the PURPA ratepayer neutrality standard because the inclusion of Chehalis in the GRID indicative price studies could lower avoided energy rates. The Committee further investigated this issue through a combination of discovery and follow-up phone conversations with Company personnel.

(2) The reasonableness of the Company's revised method for determining an avoided line loss payment for the Tesoro and Kennecott QF projects. The Committee provides brief comments on this revised method.

Discussion

Indicative prices for Tesoro & Kennecott PPAs

According to the Company's response to CCS DR 1.2, the indicative price studies for the Tesoro and Kennecott PPAs were completed in the August 11-14, 2008 time period. The Company's response to CCS DR 1.4 states the Chehalis plant was not included in either the Tesoro or Kennecott study.

The Committee followed-up with a phone call to Company representatives (Mr. Taylor and Mr. Clement) inquiring why Chehalis was excluded from the two indicative price studies. According to Mr. Clement, the existing tolling arrangement between PacifiCorp and Chehalis was scheduled to expire on September 14, 2008 and the transaction to acquire the asset was not expected to close until mid-September. Consequently, the Company decided to exclude Chehalis from the avoided cost study because of uncertainty as to whether the deal would actually close and some of the Chehalis modeling parameters were deemed to be confidential.[1]

On November 17, 2008, the Committee submitted additional discovery to the Company to determine whether including Chehalis in the GRID indicative price studies materially impacts the proposed avoided cost energy rates for the Tesoro and Kennecott PPAs. The Company's response to CCS DR 2.1, provided November 19, 2008, indicates that the impacts are negligible---$0.03/MWh for Tesoro and $0.00/MWh for Kennecott.

The Committee followed-up with a phone conversation with a Company representative, Mr. Hale, who has the responsibility of setting up and performing the indicative price studies, to gain a better understanding of the Tesoro and Kennecott avoided cost results. According to Mr. Hale, the model simultaneously optimizes the dispatch of system resources, purchases and sales such that a QF located in the east will have little opportunity to displace generation in the west. If Chehalis was located on the east side of PacifiCorp's system, then the impact on avoided cost energy prices would have likely been higher.

PURPA Ratepayer Neutrality Standard

The PURPA ratepayer neutrality standard is applied in avoided cost proceedings to ensure ratepayers are indifferent between capacity/energy provided by a QF and capacity/energy either potentially acquired or produced by a utility. Excluding Chehalis from the GRID indicative price studies for the Tesoro and Kennecott PPAs does not appear to materially impact the calculated avoided cost energy rates. In this instance, the PURPA ratepayer neutrality standard appears to be met.

However, the Company should be more careful in the future to update its indicative pricing runs with the best information available regarding resources, costs, etc. The Company included Chehalis in its July 17, 2008 rate case filing and the Commission issued an order on August 1, 2008 approving the proposed Chehalis acquisition. Chehalis exemplifies a resource addition that should have been included in the indicative price studies. If Chehalis had been an east side addition, then the impact may have been greater.

Avoided Line Loss Payments

Attached to the proposed PPAs is the Company's updated method for determining an avoided line loss payment. The method is similar to the one proposed last year for the Tesoro PPA, except an adjustment has been made to recognize the non-firm nature of the power provided under the PPAs. The revised avoided line loss method begins with the current FERC OATT rate for line losses (4.48%) multiplied by the percentage of total MWhs that the QF avoids outside the "Wasatch Front Load Center." That result is further

1 The Company's response to CCS 2.5 sets forth the same reasons why Chehalis was not included in the indicative price studies. The response further states that both Tesoro and Kennecott also requested multi-year indicative price studies beginning in 2009 and ending in 2013 and 2028, respectively. Since the Company's latest avoided cost compliance filing included a west side CCCT as the next deferrable resource, the Company maintains it would have been inappropriate to include both resources. However, the Committee notes the PPAs in the current dockets are limited to one year (2009) and the timing of the west side CCCT is 2011.

reduced based on the current difference (18.2%) between the levelized 20-year Schedule 37 firm and non-firm avoided cost rates.

The Division and Committee were included in discussions that addressed modifications to the avoided line loss calculation and we appreciate the opportunity to comment on the method as it was being revised. While the Committee believes the updated avoided line loss method is an improvement over the prior approach, we are still concerned over the possible broad applicability of the method to other potential non-firm QFs. The generation from Tesoro and Kennecott is unique in that it is an essential part of their respective on-site operational requirements. In the past this has resulted in somewhat predictable and steady amounts of output delivered to PacifiCorp. Further, both contracts include a provision requiring the QF to exclusively sell their output to PacifiCorp. For these reasons the Committee does not oppose the proposed avoided line loss adjustments for the Tesoro and Kennecott PPAs, subject to certain conditions specified in the recommendation section below.

Recommendations

The Committee recommends the Commission:

1) Approve the avoided cost energy prices for the Tesoro and Kennecott PPAs as proposed in the Company's Applications.

2) Require the Company, as part of responding to any future requests for indicative price studies, to identify and include significant changes that have occurred since the most recent avoided cost quarterly compliance filing was submitted that are expected to materially impact avoided cost results. Such updates could prove to be important if a QF requests the Company to provide a multi-year indicative price study.

3) Approve inclusion of avoided line loss payments in the Tesoro and Kennecott PPAs subject to the following:

    a. In the future if either Tesoro or Kennecott enters into a non-firm PPA with RMP that exceeds one year, or if their respective operating performance does not meet expected levels, the appropriateness of an avoided line loss payment should be re-examined.

    b. The Commission should clearly specify that approval of the Tesoro and Kennecott PPAs sets no precedent for the inclusion of avoided line loss payments for future non-firm QF contracts.

4) Allow parties time to further comment if the Division's analysis of contract prices and terms results in conclusions different than those set forth in the Company's application for approval of the PPAs.