- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of PACIFICORP, dba Utah Power & Light Company, for Approval of Standard Rates for Purchases of Power from Qualifying Facilities Having a Design Capacity of 1,000 Kilowatts or Less	DOCKET NO. 01-2035-01 ORDER

ISSUED: January 15, 2002

By The Commission:

INTRODUCTION AND PROCEDURAL BACKGROUND

In response to a Division of Public Utilities' (Division) recommendation in Docket No. 01-035-T04, this Commission issued an order on June 13, 2001 establishing this Docket and requested that PacifiCorp, dba Utah Power & Light Company (PacifiCorp or Company), update its avoided costs for Electric Service Schedule No. 37. Schedule No. 37 establishes standard prices for purchases of power from Utah-located Qualifying Facilities (QFs) with a design capacity of 1,000 Kilowatts (kW) or less. The rates are based on avoided costs developed from the Company's Integrated Resource Plan (IRP). Avoided costs are costs the Company would incur to serve its native load "but for" the generation provided by the QFs. These avoided costs have been used in other dockets to evaluate contracts and resource acquisitions.

The Division's memorandum expressed concern that the avoided costs used in Docket No. 01-035-T04, were out-of-date and could lead to inefficient resource selections. Consequently, we ordered the Company to adjust its existing approach by updating assumptions and inputs used to calculate avoided costs and file the results coincident with its June 22, 2001 filing in Oregon. The existing proxy plant method uses the cost of a combined cycle combustion turbine (CCCT) to estimate the costs avoided by purchasing power from QFs. However, to recognize the lead-time necessary to build new generation, we requested that the Company modify its method of calculation. We requested a three-stage calculation that reflects current market prices until a peaking unit can be built, and the cost of a peaking unit until a base-load plant can be built. These new calculations were to be filed on August 31, 2001.

On July 3, 2001 the Company submitted its avoided cost calculations using its existing approach with updated information and, on September 6, 2001, filed avoided costs using the method we requested as well as an alternative two stage method which the Company prefers. The Division filed its memorandum and recommendation on November 29, 2001 in response to our request for agency action. On January 3, 2002, the Committee submitted its memorandum and its recommended adjustments to the Company's calculation of avoided costs.

DISCUSSION

The current one-stage proxy plant method for calculating avoided costs appears to be inadequate because it fails to recognize the lead-time necessary to build new plant. In the past, the use of this method was acceptable because either new plant was not needed or one could assume that open market purchases could be obtained at or below the average cost of new plant. The fact is the Company is currently short of capacity and the recent gyrations in the wholesale market make such assumptions obsolete. Thus, a more accurate method is required.

The Company's filing of September 6th provides a calculation with the three-stage method we suggested. In addition, the Company provides its own preferred two-stage calculation that it believes adequately deals with the lead-time problem. The Company uses its own "Official Market Price Projections" to estimate the costs of wholesale power until a peaking

unit can be built. These prices are quotes obtained by PacifiCorp in late August 2001 from independent third party power marketers. These quotes are used as estimates of the Company's avoided costs until new plant can be constructed which the Company estimates to be between 6-12 months time for a peaking unit, i.e., a simple cycle combustion turbine (SCCT) and 34 months for a base-load CCCT.

For the Commission requested three-stage method, the Company uses its wholesale estimates for 12 months. For the next 22 months, the theoretical costs of the peaking unit are used until a CCCT can be constructed. The theoretical CCCT costs are used in the latter years of the calculation. The costs are then levelized assuming a given capacity factor over a 20-year contract starting in 2001. The levelized price, assuming an 85 percent capacity factor, is $53.65. This is 65 percent higher than the current levelized rate of $32.45 per megawatt hour for the 2000 to 2019 time period. The Company's preferred alternative reduces this calculation to a two-stage process. In the first stage, the Company uses its Official Market Price Projections to estimate the costs of power until a base-load unit can be built some 34 months later. Using this method, the levelized price is $48.49 per megawatt hour.

Any estimation of avoided costs requires assumptions regarding the Company's future loads and resources, the least-cost plant type, natural gas prices, market prices, inflation, discount rates, and the calculation of annual payment factors for power plant capital costs. The Division reviews these assumptions and inputs to insure that they are consistent with past practices and assumptions used in other venues. The Division notes a number of differences in assumptions and inputs used by the Company and recommends changes where appropriate.

For example, this filing's load and resource balance differs from RAMPP-6 projections as a result of reductions and additions to wholesale contracts and new resource additions. The load forecast also differs from RAMPP-6 projections and reflects changes made by the Company in its Oregon filing to implement HB 1149, Oregon's restructuring legislation. The Division states that no analysis was provided by PacifiCorp to support the change in load forecasts. The Division points out other minor modeling changes to the load and resource balance such as updates to maintenance schedules, forced outage rates, heat rates, O&M costs and the correction of discovered errors. The Division's review indicates that although load and resource assumptions differ, they are similar to RAMPP-6 inputs and produce results that are consistent with the conclusion that energy and peak deficits exist in the year 2001.

However, the Division believes other changes in modeling inputs need further analysis and are discussed below. The determination of avoided costs is dependent on the selection of the least-cost plant that is avoided. The Company selects a CCCT as the appropriate proxy. A coal plant is least-cost when gas prices are higher than $2.80 per MMBtu assuming a zero real escalation rate over a 20-year period. Although the Company's filing assumes higher gas prices, the CCCT has a shorter construction lead-time than a coal-fired plant. The Company also assumes a negative escalation rate for real price increases for natural gas over the planning horizon. Thus, the Division concurs with the Company that a CCCT is the appropriate base-load proxy plant under these circumstances. As a measure of comfort, the cost estimate for a CCCT is quite close to the cost of a coal-fired plant.

For natural gas prices and escalation rates to calculate the running costs of gas-fired units, the Company uses its own internal projections. This starts off with a price of $3.64 per MMBtu in 2001 then declines and assumes a variable escalation rate which averages about 1.7 percent nominal or negative 1.1 percent in real terms over the next 20 years. The Division concurs with this estimate and notes that although the starting point is slightly higher than a Questar forecast made about the same time, PacifiCorp's use of a lower escalation rate makes the forecast comparable over the planning horizon. Gas prices have fallen since the filings were prepared.

Short-run wholesale prices are estimated using the forward price quotes obtained by the Company. These quotes are not forecasts but rather they are an average of quoted prices for contracts that the Company could obtain for delivery of standard power products. The Division has little confidence in these values in the future and recommends that they only be used for the interim measure of avoided cost until a peaking unit can be built. The use of these quotes could lead to greater uncertainty because the quotes can change on a day-by-day basis.

QFs have the option of either being paid according to the annual rates in the schedule or receive a levelized rate for the entire 20-year contract. In this filing the Company used a 10.3% discount rate to calculate the levelized payment rather than the after-tax cost of capital that has been used in the past. No explanation was given for the change. The Division

recommends the use of an after-tax cost of capital of 7.82% for the discount rate. In addition, the Division's review finds that the Company uses different inflation and cost escalation rates which appear to be inconsistent. Finally, the Division finds the omission of property taxes from the calculation of levelized rates to be inconsistent with RAMPP-6 calculations. After making the changes, the Division derives its own calculation of avoided costs using the three-stage method that increases the avoided cost from $53.65 to $56.57. The Commission finds that the Division's recommended revisions to the Company's filing are more consistent with past filings and more accurately reflect the Company's avoided costs.

The Committee's memorandum agrees with the Division's comments and supports the three-stage calculation method as well as the suggested changes to discount rates, inflation and escalation rates and the inclusion of property taxes. In addition, the Committee recommends that the Commission adopt three other adjustments. The first recommendation is the adoption of a lower long-term price forecast for natural gas, second, higher generating unit efficiencies that reflect recent improvements in gas-fired technologies, and third, lower capital cost estimates reflecting greater availability of gas-fired generation units. Taken together, these adjustments yield an avoided cost of $51.90 per MWh. The Committee believes that the Company's natural gas price forecasts are inaccurate because they were developed in August 2001. The Committee points out that the previous year witnessed a tremendous increase in gas prices which caused a great deal of uncertainty in the markets. Since August 2001, the gas market has settled down and the Committee believes that current forecasts showing lower estimates are more accurate and better reflect the historical trends observed before the recent fly-up in prices.

The Committee also questions the heat rates used by the Company for the SCCT cost calculations. The Committee states that the Company assumes the installation of a low efficiency unit, in spite of the fact that the heat rate on the proposed Gatsby plant is more efficient. The Committee recommends an assumed heat rate that is the average of the three units that the Company was actively considering. The Committee also cites the recent decline in costs for the combustion turbines. The argument for lower costs rests on a change in market fundamentals. The recent crisis in California and the resulting escalation of wholesale prices in the West spurred an increased demand for new generation. This in turn caused prices for generators to increase dramatically. However, the decrease in demand resulting from the current recession and the changes made in the California market have caused turbine prices to fall. The Committee wants the avoided cost calculation to reflect these changes in the turbine market.

The Company supports its alternative two-stage method and the Division observes that RAMPP-6 does not select a peaking unit for the near term given the range of wholesale prices, natural gas prices and lead-time for a peaking unit adopted in the study. However, some RAMPP-6 scenarios do support the construction of a peaking unit particularly with higher peak hour wholesale prices and reduced lead-times. The Division notes that the Company has submitted a request for a certificate of public convenience and necessity for a SCCT at the Gadsby site.

FINDINGS OF FACT AND CONCLUSION OF LAW

1. PacifiCorp is a public utility that provides retail electric service in the states of California, Idaho, Oregon, Utah, Washington, and Wyoming. PacifiCorp conducts its electric utility business in the state of Utah under the assumed business name of "Utah Power & Light Company".

2. Applicant's rates for the purchases of capacity and energy from QFs are subject to Commission jurisdiction pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978 and Utah Code Ann. Section 54-12-2.

3. PacifiCorp last submitted, for the Commission's approval, standard avoided cost rates for QFs of 1,000 kW or less in Docket Nos. 97-2035-02 and 00-2035-02. Those rates, submitted to the Commission on October 10, 2000, were based on a load and resource plan developed in conjunction with the PacifiCorp's draft RAMPP-6, and were updated to incorporate known and measurable changes in assumptions and inputs.

4. The Division has reviewed the Company's application and analyzed the method of calculating avoided costs requested by the Commission and the method proposed by the Company. The Division recommends that the Commission ordered method be used to determine avoided cost and rates reflecting those costs for QFs under one megawatt.

1. 5. The Commission finds that its requested three-stage method is preferable because it provides a more stable

estimation of avoided costs and thus will be used to determine avoided costs in this docket.

6. The Division further recommends a number of corrections to the Company's calculation of avoided costs that results in a higher rate for QFs. The Division bases its recommendation on logical consistency and consistency with other filings made by the Company.

7. The Commission finds that the Division's recommended provisions to the calculation of avoided costs are in the public interest in that they bring a more logical and consistent approach to avoided cost calculations.

8. The Commission finds that the adjustments recommended by the Committee to update the calculation of avoided cost rates provide a more accurate estimate at this time. Thus we find that the avoided costs recommended by the Committee are reasonable and in the public interest.

9. The avoided costs used and approved in this docket should be assumed to be representative of avoided costs used in other dockets unless a party can make a case otherwise. These costs should be used for determining the measure funding limits for demand-side resource acquisition decisions.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED, that:

The avoided cost rates, terms, and conditions contained in the Division's Attachment G of its November 29, 2001 filing as adjusted by the Committee's January 3, 2002 memorandum are approved by the Commission as just and reasonable rates in purchases involving QFs with a design capacity of up to 1,000kW. The adjustments result in an avoided cost of $51.90 per MWh. The Company will submit to the Commission the appropriate tariff sheets for Electric Service Schedule No. 37 that reflect the decisions made in this order by January 30, 2002.

DATED at Salt Lake City, Utah, this 15th day of January 2002.

/s/ Stephen F. Mecham, Chairman

/s/ Constance B. White, Commissioner

/s/ Richard M. Campbell, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary