

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application)
of PacifiCorp for Approval) Docket No. 03-035-14
of an IRP Based Avoided Cost)
Methodology for QF Projects)
Larger than 1 Megawatt)
)

Surrebuttal Testimony of Bruce N. Williams

May 12, 2004

1 Q. Are you the same Bruce N. Williams that filed direct and rebuttal testimony in
2 this docket?

3 A. Yes.

4 Q. What is the purpose of your surrebuttal testimony?

5 A. My testimony responds to the concerns of Messrs. Swenson and Gutting about the
6 clear cost a Qualifying Facility (QF) power purchase contract imposes on Utah
7 customers. I explain how that cost is calculated and how it should be factored
8 into the price paid to QF generators.

9 Q. What is the purpose of adjusting the price paid to QF generators when the power
10 purchase contract results in a fixed obligation to the utility?

11 A. The purpose of the adjustment is to price the amount paid to QF generators at a
12 level that reflects the value to retail customers. The amount of the adjustment will
13 not be used to purchase utility equity. The value of the adjustment would flow to
14 retail customers in the form of a lower revenue requirement.

15 Q. How is the adjustment calculated?

16 A. The calculation of the adjustment can be viewed as the cost of issuing new equity
17 and retiring debt so as to rebalance the capital structure to the same debt-to-equity
18 ratio level that existed before the QF contract created a liability for the utility. By
19 maintaining the same percentage of equity in the capital structure the fixed charge
20 coverage ratio and other ratios considered by credit rating agencies when
21 evaluating credit quality will not be adversely affected.

22 As the utility continuously acquires new capital to build a variety of electric
23 assets, the adjustment can be alternatively viewed as the cost of financing

1 subsequent assets with 100% equity to rebalance the capital structure. Absent the
2 QF contract liability subsequent assets would normally have been financed with a
3 blend of debt and equity. The financing cost imposed by the QF contract is the
4 difference between the cost of equity and the blended cost of financing times the
5 amount of capital required to rebalance the capital structure. An example of the
6 calculation is provided in Surrebuttal Exhibit BNW-1, which shows the cost
7 assuming a power purchase contract results in a \$100,000 liability or debt
8 equivalent at the utility. Given those assumptions the annual cost would be
9 \$5,149. This cost is scalable and applies to both large and small purchased power
10 contracts. Mr. Griswold explains that this cost should be applied as a monthly
11 line-item adjustment to the QF monthly payment.

12 The liability and the related cost associated with a QF power purchase
13 contract are expected to diminish over time as the length of the remaining contract
14 diminishes. The result is a larger adjustment in the early contract years and a
15 smaller adjustment in later years.

16 Will the utility immediately issue equity to rebalance the capital structure for
17 each QF contract?

18 A. From a practical and economic perspective, equity issuances typically
19 occur in amounts larger than would be required to rebalance the capital
20 structure for a single QF contract. For the same reasons it is often
21 economic to issue debt in blocks of \$100 million or more, it is also
22 economic to issue equity in large block amounts. Consequently, the
23 timing of an equity issue may not occur simultaneously with signing a

1 QF contract. Yet, equity will be issued to rebalance the capital
2 structure and maintain the utility credit quality.

3 Q. If a QF contract does not require the utility to immediately issue equity, should
4 the cost adjustment apply?

5 A. Absolutely yes. The cost applies to every contract that reduces the credit capacity
6 of the utility. Each contract should bear its prorata share of that cost. To not
7 recognize this cost on early contracts would require that the “last contract” that
8 trips the requirement to issue equity would bear the entire cost of equity issued to
9 rebalance the “last contract” and all prior contracts. It is inappropriate to burden a
10 single contract with costs associated with other transactions. The cost calculation
11 methodology proposed by the Company fairly assigns the prorata share of this
12 cost to each contract in relation to the imposition placed upon the utility.

13 Q. Do all QF contracts result in a liability that reduces the utility credit capacity?

14 A. Certain short-term contracts may not result in a GAAP liability or debt equivalent.
15 If that is the case, the cost adjustment should not apply. However, the majority of
16 QF contracts is expected to result in liabilities or debt equivalents at the utility, as
17 most QF contracts are long-term and have fixed components. Most long-term
18 contracts will result in a fixed obligation to the utility that amounts to a liability
19 according to Generally Accepted Accounting Principles (GAAP), or a debt
20 equivalent in the eyes of the credit rating agencies. When a QF contract results in
21 a liability on the utility balance sheet or a debt equivalent from the perspective of
22 the credit rating agencies this cost should apply.

1 Q. Can the Commission establish standards so that QF generators can know upfront
2 whether or not a contract will incur a cost for reducing the credit capacity of the
3 utility?

4 A. Yes. For any contract that results in a liability on the utility balance sheet, the
5 cost adjustment should apply to the amount of equity required to rebalance the
6 capital structure for that specific contract. The amount of that liability will be the
7 net present value of fixed payments to the QF using the most recently authorized
8 after-tax cost of capital for the utility as the discount rate. To understand the
9 impact upfront, the QF can consult its accountant to assess whether or not the
10 specific contract they propose to the utility will be subject to the accounting
11 standards laid out in EITF 01-08, FAS No. 13, or FIN 46R. Certain contracts may
12 not result in a book liability, yet the credit rating agencies will evaluate the
13 contract as a debt equivalent. Standard & Poor's has indicated that many
14 contracts with a life of three or more years result in a debt equivalent. If a
15 contract does not result in a book liability, yet it has a life of more than 3 years,
16 the cost adjustment should apply to the amount of equity required to rebalance the
17 impact of the debt equivalent calculation publicly published by Standard &
18 Poor's.

19 The cost of rebalancing the capital structure for either a book liability or a
20 debt equivalent will follow the formula laid out in Surrebuttal Exhibit BNW-1,
21 which is described as the difference between the pretax cost of equity less the
22 pretax weighted average cost of capital times the amount of equity required to
23 rebalance the authorized capital structure, *ceteris paribus*. To the extent that

1 prevailing electric rates were established by stipulation rather than Commission
2 order, the implied cost of capital in the stipulation will serve as the basis for this
3 calculation.

4 Q. Will inclusion of this cost in the price paid to QF generators result in a penalty or
5 underpayment to the QF?

6 A. Absolutely not. Inclusion of this cost in the price paid to QF generators merely
7 assures that Utah customers are financially indifferent to a QF purchase or the
8 equivalent option. Absent this cost factor in QF pricing, Utah customers will end
9 up subsidizing QFs or paying more than is appropriate for the value of energy
10 provided by QF generators.

11 Q. Does this conclude your testimony?

12 A. Yes.