



State of Utah

DEPARTMENT OF COMMERCE
Committee of Consumer Services

To: The Public Service Commission

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Subject: Docket No 03-035-T10 - Recommendations of the Committee of Consumer Services Regarding Schedule 37: Avoided Cost Purchases from Qualifying Facilities Less Than 1 MW

1 Background

On 12 September 2003, PacifiCorp filed updated avoided cost rates (avoided costs or rates) for Electric Service Schedule No. 37. This schedule provides the standard rates for purchases from qualifying facilities (QFs) that are under one megaWatt in size. However, PacifiCorp has also historically used its approved avoided costs for other important purposes, such as evaluating the cost-effectiveness of demand-side management (DSM) programs and in setting prices for special contract customers.

On 7 October 2003 the Division of Public Utilities (Division) filed its response to an action request from the Public Service Commission. In its analysis, the Division recommends adoption of the proposed avoided costs. This memo provides the Committee's recommendations in this docket.

2 Recommendation

The Committee recommends that the Commission take no action until PacifiCorp's data assumptions stemming from its 2003 Integrated Resource Plan (IRP), which the proposed avoided costs are based upon, can be compared to those used in its Next Best Alternative (NBA) for RFP-2003A. The Company issued this RFP to secure resources as part of its 2003 IRP. According to PacifiCorp, this data and information will be publicly available in the near future. The information used in PacifiCorp's NBA should reflect its best commercial estimate of constructing a new Simple Cycle Combustion Turbine Unit (SCCT) and a new Combined Cycle Combustion Turbine Unit (CCCT). Because PacifiCorp is comparing the NBA alternative to the competitive proposals that it received from parties responding to RFP-2003A, PacifiCorp's updated SCCT and CCCT cost estimates should reflect more current (accurate) information. The Committee believes that the most current data available should be used to set new Schedule No. 37 avoided costs.

If the Commission elects to approve and implement new avoided costs at the present time, the Committee alternatively recommends that the Commission adopt the proposed avoided costs on an interim basis and order PacifiCorp to revise them when updated information is available.

3 Analysis

As required by the Commission's IRP Standards and Guidelines set in Docket 90-2035-01, "avoided costs should be determined in a manner consistent with the Company's Integrated Resource Plan."¹ While the Division notes in its 6 October recommendations that many of the assumptions used to determine the avoided costs are consistent with PacifiCorp's 2003 IRP, the Company has just updated its IRP in a filing made yesterday (3 November). In addition, PacifiCorp's response to the Division's Data Request 1.3 in this docket indicates that changes to key data assumptions may be introduced in PacifiCorp's NBA analysis. Although no formal rulemaking is in place for PacifiCorp's RFP process, resource acquisitions are expected to reflect the IRP. Therefore, it is reasonable that the assumptions used in the IRP should also comport with what is found in the Company's most recent NBA. Until that data becomes publicly available, however, there is no way to know if the data assumptions relied on in the IRP are consistent with the most up-to-date information used in PacifiCorp's RFP process.

In comparing the previous Schedule No. 37 avoided costs to the those proposed in the current filing, the Committee found that several data assumptions have significantly changed which result in higher avoided costs. The Committee believes the following areas require further examination:

- capital costs;

¹ Standard and Guidelines for Integrated Resource Planning for PacifiCorp, Utah Jurisdiction, page 35, point 7.

- heat rates;
- levelization rates; and
- avoided cost volatility.

3.1 Capital Costs

PacifiCorp's assumed capital cost for a SCCT has increased from \$505/kW to \$554/kW, and for a CCCT from \$603/kW to \$767/kW. These represent a 9.7% and 27.2% increase, respectively. The increase in the capital cost for a CCCT is significant. The \$767/kW CCCT is the highest cost unit that PacifiCorp considered in its 2003 IRP. The Company also considered other CCCT units such as one priced at \$650/kW. While \$650/kW is much lower than the capital cost assumption used in the proposed avoided cost filing, it is still much higher than the \$603/kW used in the development of the current avoided costs.

In its filed comments concerning the avoided costs that were set in 2002, the Committee noted that because of the rush to build new capacity during the 2000-2001 energy crisis and the subsequent large number of project cancellations, a secondary market of available new equipment at reduced prices emerged. Many experts in the industry today recognize that the existence of this secondary market led to a sharp downward impact on capital costs associated with new generating units. Therefore, the Committee wants to ensure that the Company has acknowledged this trend in its estimates of SCCT and CCCT capital costs.

Since the capital cost factor materially impacts the level of avoided costs, the Committee believes it is necessary to use up-to-date SCCT and CCCT capital cost assumptions. Such assumptions should be reflected in PacifiCorp's NBA and they should be the starting point for determining the reasonableness of the Company's proposed avoided costs.

3.2 Heat Rates

For purposes of calculating current avoided costs, PacifiCorp used a SCCT heat rate of 11,159 Btu/kWh, and a CCCT heat rate of 6,980 Btu/kWh. In the recent Schedule No. 37 avoided cost filing, these heat rates have increased to 12,176 Btu/kWh and 7,074 Btu/kWh, respectively. Increases in heat rates represent a decrease in generating unit efficiency and lower unit efficiency typically correlates with lower SCCT and CCCT capital costs. However, the Company inexplicably assumes both lower generating unit efficiency and higher capital costs. This relationship between unit heat rates and capital cost requires further investigation.

Furthermore, the Committee believes that a heat rate value of 12,176 used for a SCCT is unreasonably high. This is yet another reason why the updated information that PacifiCorp is relying on in its NBA analysis should be compared to the data assumptions used in its avoided cost filing.

3.3 Levelization Rates

Levelization rates represent an additional area that has increased substantially in this filing. Levelization rates are used to annualize fixed capital revenue requirements (depreciation, taxes, insurance, debt and equity return components, etc.) associated with the construction of generating units. PacifiCorp's approved avoided costs reflect calculations based on a levelization factor of 8.59% for a SCCT and 8.37% for a CCCT. The Company's proposed avoided costs incorporate much higher levelization factors – 9.59% for a SCCT and 8.61% for a CCCT – without any accompanying explanation. Since the levelization rates impact the avoided cost calculation, the Committee believes the Company needs to fully explain its proposed increases in this area and compare these increases to the assumptions used in its NBA analysis.

3.4 Avoided Cost Volatility

Avoided cost volatility is the final issue that the Committee believes should be addressed. As illustrated in Table 1 below, PacifiCorp's proposed avoided costs fluctuate more widely in the early years compared to the approved avoided costs, particularly during years 2005 and 2006. This volatility appears to be rooted in both the method used for calculating avoided costs (market for two years; SCCT proxy for two years; CCCT proxy for the remaining period) and, in particular, the assumptions underlying the SCCT proxy.

Comparison between Proposed and Current Avoided Costs

Table 1

Year	Proposed Avoided Costs (\$/MWH)	Current Avoided Costs (\$/MWH)	Difference (\$/MWH)
2003	\$45.81	\$47.38	-\$1.57
2004	\$46.77	\$44.10	\$2.67
2005	\$61.39	\$38.77	\$22.62
2006	\$52.15	\$39.66	\$12.50
2007	\$43.28	\$39.89	\$3.39

If the Commission were to adopt these new avoided costs, the avoided costs from one year to the next will be dramatically different and may result in unintended subsidies of QF resources by Utah ratepayers. Updating the data assumptions used by the Company in its avoided cost filing to those same assumptions contained in the aforementioned NBA analysis and updated IRP may reveal a more realistic and sensible avoided cost picture.

4. Conclusion

The Committee urges the Commission take no action on the Company's proposed avoided costs until more up-to-date information becomes available from PacifiCorp and can be reviewed by interested parties. Using more accurate information and data will provide QFs a fair avoided cost, while protecting Utah ratepayers from any undue subsidy.