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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Petition of Spring Canyon
LLC for Approval of a Contract For the Sale of
Capacity and Energy From Its Proposed QF
Facilities

DOCKET NO. 05-035-08

In the Matter of the Petition of Pioneer Ridge
LLC & Mountain Wind For Approval of a
Contract For the Sale of Capacity and Energy
from its Existing and Proposed QF Facilities

DOCKET NO. 05-035-09

PREFILED TESTIMONY OF RICH COLLINS

The UAE Intervention Group hereby submits the Prefiled Testimony of Rich Collins in this docket.

DATED this 18th day of March, 2005.

HATCH, JAMES & DODGE

/s/ _____
Gary A. Dodge
Attorneys for UAE Intervention Group

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 18th day of March, 2005, to the following:

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PREFILED TESTIMONY

Of

RICHARD S. COLLINS

On behalf of UAE Intervention Group

In the Matter of the Petition of Spring Canyon LLC for Approval of a Contract For the Sale of
Capacity and Energy From Its Proposed QF Facilities

Docket No. 05-035-08

In the Matter of the Petition of Pioneer Ridge LLC & Mountain Wind For Approval of a Contract
For the Sale of Capacity and Energy from its Existing and Proposed QF Facilities

Docket No. 05-035-09

March 18, 2005

1 **BACKGROUND**

2 **Q. Please state your name and occupation.**

3 A. My name is Richard S. Collins. I am an Associate Professor of Economics and
4 Finance at Westminster College located at 1840 South 1300 East, Salt Lake City,
5 UT 84108.

6 **Q. On whose behalf are you filing testimony in this Docket?**

7 A. The UAE Intervention Group.

8 **Q. Have you submitted testimony to this Commission before?**

9 A. Yes. I submitted prefiled testimony dated May 6, 2004, in Docket 04-035-14, the
10 QF avoided cost docket that led to the stipulation under which the parties in these
11 dockets are requesting contracts.

12 **Q. Do you have experience in utility regulatory matters?**

13 A. Yes. Prior to my position at Westminster College, I worked for the Public Service
14 Commission of Utah for approximately 13 years.

15 **Q. Please describe some of your responsibilities at the Commission.**

16 A. I provided technical advice to the Commission on rate proceedings and a variety
17 of other issues. I was responsible for tracking PacifiCorp's IRP planning process,
18 avoided cost, demand-side management, cost of capital, and deregulation issues.
19 In addition, I helped write orders and wrote or coauthored a series of technical
20 reports on deregulation issues for the Commission and the legislature.

21

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1 **SUMMARY OF TESTIMONY**

2 **Q: What is the purpose of your testimony in these dockets?**

3 A: I will provide a brief background into PURPA and avoided costs and explain why
4 it is critical that the Commission maintain consistency and certainty of QF pricing
5 in order to implement both federal and state policy to encourage energy efficiency
6 and promote energy independence.

7 **Q: Could you give a summary of your conclusions and recommendations?**

8 A: Yes. In my testimony, I explain that encouragement and development of QF
9 Projects is in the public interest because QF projects are efficient in their
10 utilization of energy, they allow Utah businesses to be more efficient and
11 competitive, and they provide benefits to ratepayers. I also explain that stability
12 and predictability of pricing, transparency in the pricing process, and prompt
13 access to dispute resolution are essential to QF development. I explore reasons
14 why utilities have inherent biases against QF projects and emphasize the critical
15 role played by the Commission in facilitating QF development.

16 I also discuss why it is in the public interest for Stipulation pricing to
17 remain available pending the development of an approved avoided cost
18 methodology. I explain that the stipulation prices are conservative, represent a
19 fair compromise of competing positions, and remain reasonable under current
20 circumstances.

21 Finally, I explain the importance of allowing existing QF contracts to be
22 renewed and emphasize the need for timely approval of an ongoing avoided cost

1 methodology.

2 **Q: Can you give some background into PURPA and the State of Utah's laws on**
3 **cogeneration and renewable resources?**

4 A: The Public Utility Regulatory Policies Act (PURPA) is a U.S. federal law enacted
5 in 1978 to encourage more energy-efficient and environmentally friendly energy
6 production. The result of this act has been the development and adoption of new
7 technologies such as combined heat and power (cogeneration) and alternative fuel
8 sources such as wind, solar, water and waste to produce electricity. PURPA
9 defined a new class of energy producer called a qualifying facility or QF. Utilities
10 are required to purchase power generated by QFs at the utility's avoided costs.
11 PURPA was passed in the midst of an energy crisis that ripped through industrial
12 world economies with devastating effects. Promotion of QF power is intended to
13 stem the U.S.'s growing dependence on foreign oil and rising energy costs.
14 Today's energy environment is remarkably similar to the late 1970's.

15 Like the United States, the State of Utah has recognized the benefits of
16 QFs and has passed legislation mandating the promotion of these resources. Utah
17 Code Section 54-12-1 provides:

18 (1) The Legislature declares that in order to promote the more rapid
19 development of new sources of electrical energy, to maintain the
20 economic vitality of the state through the continuing production of
21 goods and the employment of its people, and to promote the efficient
22 utilization and distribution of energy, it is desirable and necessary to
23 encourage independent energy producers to competitively develop
24 sources of electric energy not otherwise available to Utah businesses,
25 residences, and industries served by electrical corporations, and to
26 remove unnecessary barriers to energy transactions involving

1 independent energy producers and electrical corporations.

2
3 (2) It is the policy of this state to encourage the development of small
4 power production and cogeneration facilities, to promote a diverse
5 array of economical and permanently sustainable energy resources in
6 an environmentally acceptable manner, and to conserve our finite and
7 expensive energy resources and provide for their most efficient and
8 economic utilization.

9
10 The legislature recognized that QFs owned and operated by Utah businesses are
11 more efficient in their utilization of energy and will make Utah firms more
12 competitive. Power production from renewable QF's will also help mitigate
13 harmful emissions and thus improve our environment.

14 **Q: Has there been much development of QF power in Utah?**

15 A: Prior to this Commission's approval of the stipulation in Docket 04-035-14, there
16 was very little QF development within the state.

17 **Q: What do you think was the cause of this lack of development?**

18 A: Before the stipulation, neither circumstances nor the regulatory climate was
19 conducive to QF development. Until the last several years, the utility did not
20 project the need for new facilities for a number of years. Its projected avoided
21 capacity costs were thus very low. Even after the utility began to recognize its
22 pressing need for new resources, some of the essential requirements for QF
23 development were still not in place before the stipulation was approved. A
24 transparent pricing method did not exist. The pricing for QFs was neither stable
25 nor predictable. There was no established process for quick resolution of disputes
26 before the Commission. The utility was thus able to frustrate and delay

1 companies interested in developing QF projects.

2 Utilities tend to have inherent biases against QFs and, if permitted, can
3 effectively thwart QF development. Thus, stable and predictable pricing, a
4 transparent pricing process and prompt access to Commission resolution of
5 disputes are essential to counter these biases. The lack of a proper regulatory
6 environment for QF development causes a chicken and egg problem: seed money
7 necessary to evaluate QF projects is often dependent upon availability of QF
8 pricing and contract terms. Without receiving requests for QF contracts,
9 regulators do not feel an urgency to set QF prices. Thus a lack of transparent
10 pricing and contract terms thwarts QF development.

11 **Q: Why would a utility be biased against QF development?**

12 A: There are several reasons. First, the utility has a financial motive to discourage
13 QF purchases. The utility makes its profits by earning its authorized rate of return
14 on investments, i.e., rate-based capital expenditures. A power purchase agreement
15 from a QF is recovered in rates but does not earn a rate of return. Thus, a QF
16 purchase denies the utility an opportunity to increase its profits for its
17 shareholders. Another reason is that utilities may not have complete control over
18 QF projects, making them less attractive to utilities than their own projects. Also,
19 utilities may desire to exclude competition in generation and protect competitive
20 advantages. Finally, a utility may want to protect its ratepayers from overpaying
21 QFs, which could lead to higher rates.

1 **Q: So it can be argued that by thwarting QF development, the utility may think**
2 **that it can both protect ratepayers from higher rates and shareholders from**
3 **lower profits?**

4 A: Yes, that is one of the reasons why utilities tend to underestimate their avoided
5 costs.

6 **Q: Should the Commission take the same stance, that is keep QF rates lower in**
7 **order to avoid the potential for higher rates and lower utility profits?**

8 A: No. That approach is neither consistent with the law nor in the public interest.
9 The Commission should set full, but reasonable, avoided costs in order to
10 minimize costs to ratepayers, while also furthering the public interest in efficient
11 utilization of scarce resources and enhancing the economic vitality of Utah. The
12 Commission is required by law to encourage QF development by setting rates
13 based on a utility's full avoided costs.

14 **Q: Has the stipulation succeeded in encouraging QF projects in Utah and if so,**
15 **why?**

16 A: Yes, the stipulation has been at least somewhat successful; several QF contracts
17 have been signed and more are expected. In fact, the petitioners in these dockets
18 are seeking QF contracts under the stipulation. The reason why QF development
19 has occurred in the last 6 to 8 months is that, for the first time in several years, QF
20 developers have had a clear pricing signal and a relatively straightforward
21 contracting policy. The Commission should be commended for approving a

1 stipulation that established conditions that permit and encourage the development
2 of efficient QF projects within our State. The Commission should ensure that
3 those conditions continue into the future.

4 **Q: What is your recommendation regarding the continued availability of**
5 **stipulation pricing?**

6 A: The Stipulation and its pricing should remain available until a new avoided cost
7 methodology and attendant pricing are approved by the Commission. Rejecting
8 the stipulation pricing will simply lead to continued litigation over appropriate
9 pricing. This will create uncertainty and thus thwart QF development in the
10 interim. Reopening the stipulation pricing because of allegations of subsequent
11 changes would be akin to reopening approval of Currant Creek or Lakeside
12 because gas prices have dramatically increased.

13 **Q: Does the stipulation pricing still reflect fair prices that will maintain**
14 **ratepayer neutrality?**

15 A: Yes, I believe it does. The stipulation was entered into in good faith and
16 represents a reasonable compromise of competing positions and avoided cost
17 methodologies.

18 **Q: Is the stipulation pricing too high under current circumstances?**

19 A: No. Although some parties maintain that the capacity prices in the stipulation are
20 now too high, that conclusion can reasonably be reached only if one adopts a

1 particular avoided cost methodology over all of the others. The parties reached a
2 stipulation as to pricing, not methodology. Several parties argued at the time, and
3 undoubtedly will argue again, that legitimate avoided costs are much higher than
4 those accepted in the stipulation.

5 Also, one must recognize the reality that gas price estimates at the time the
6 stipulation was adopted by the Commission were substantially lower than today.
7 A QF that agreed to a contract based on the stipulation's fixed prices would be
8 providing the utility and its ratepayers considerable savings today.

9 **Q: Are you aware if any QFs took this fixed price option?**

10 A: No. A wind developer may find such a fixed price contract financially attractive,
11 but a combined heat and power QF probably would not.

12 **Q: Has the Company requested that the fixed price option in the stipulation be**
13 **updated to reflect the higher natural gas prices?**

14 A: No, it has not. In fact, to my knowledge, the Company did not reveal to the
15 Commission or the parties who negotiated the stipulation that its June price
16 forecasts were substantially higher. Use of the June price forecast would have
17 increased fixed QF prices. Gas prices have risen dramatically since then, but the
18 stipulation remains in place without any effort by the Company to increase the
19 fixed prices.

20 **Q: Is there a legitimate concern that a contract with a fixed capacity cost and**

1 **floating energy prices will harm ratepayers?**

2 A: No, because the avoided capacity costs reflected in the stipulation represent a fair
3 and reasonable estimate of the utility's long-term avoided capacity costs.

4 **Q: Some parties suggest that the capacity payments agreed to in the Stipulation**
5 **are too high and do not reflect changed circumstances. Do you agree?**

6 A: No, I do not agree. The capacity payments are not too high. The Commission
7 must remember that the Stipulation was a compromise of competing
8 methodologies. PacifiCorp's QF methodology is but one of these competing
9 methodologies and tends to produce prices that are substantially lower than other
10 methodologies. Task force analyses and methodologies supported by other parties
11 produce higher avoided costs, particularly in the earlier years. The Company's
12 methodology understates capacity costs in the so-called "sufficiency period" - the
13 period of time when the Company projects that it will need capacity only during
14 certain months. PacifiCorp insists on paying QF projects for capacity only in
15 those months when it projects capacity shortfalls, while it asks for 12 months of
16 capacity payments for facilities that it builds. This is fundamentally inconsistent
17 with legitimate avoided costs. Particularly unsettling is that the Company also
18 insists on basing sufficiency period capacity payments on the average monthly
19 capacity costs of a facility. This is akin to offering to rent a condo at Snowbird
20 from an individual who owns it and suggesting that a fair price for a week would
21 be 25% of his monthly mortgage payment, even if you only want it during the

1 week of Christmas or President's Day, times when rental rates are at their peaks.

2 The result of this Company supported method is unreasonably low front-end
3 capacity payments that discourage QF development.

4 **Q: Do ratepayers benefit from legitimate, full and accurate avoided cost prices?**

5 A: Yes, they do. The ratepayer indifference standard is an important protection for
6 ratepayers, but it should not be used as a tool to thwart the overall best interests of
7 ratepayers. Establishing legitimate and full QF prices is also very important to
8 ratepayers. Ratepayers benefit from diversity, including diversity in source of
9 supply, fuel, distributed generation, etc. Society benefits from increased
10 efficiency of QF resources. They extend our limited energy resources and reduce
11 environmental impacts of energy production.

12 **Q: There is considerable uncertainty over future energy prices. Should we wait
13 to see if current prices hold before we set prices?**

14 A: No. Uncertainty over future pricing and events should not lead to resistance of
15 QF projects or unreasonably conservative assumptions. Similar cost uncertainties
16 exist for company-owned projects and yet the Company pushes forward with the
17 development of its resources. In the interests of ratepayers, QF developers and
18 society at large, the Commission should continue to provide prompt, clear and
19 transparent price signals to potential developers.

20 **Q: There is controversy surrounding the stipulation cap of 275 MW. Should the
21 Commission apply the cap only to the firm component of QF contracts?**

1 **Should the cap be expanded?**

2 A: I believe that the cap should apply only to the firm component of contracts. The
3 reason for the cap was to protect ratepayers from a perceived risk of long-term
4 fixed capacity or fixed power payments prior to Commission approval of an
5 avoided cost methodology. The cap makes the most sense in the context of
6 capacity payments. Non-firm contracts, which receive energy-only pricing tied to
7 an electric index, cause little legitimate concern for ratepayers. Alternatively, the
8 cap should be expanded to accommodate efficient QF projects that are prepared to
9 proceed.

10 **Q: How should wind powered QFs be treated in relation to the capacity cap?**

11 A: A wind powered resource's capacity should be prorated according to the capacity
12 payments it receives. For instance, if wind powered QFs receive a 20% capacity
13 payment, then only 20% of the project's maximum capacity should count against
14 the cap.

15 **Q: An issue has been raised about availability of additional capacity under the**
16 **cap as contracts for existing projects expire. Do you have any comments on**
17 **this issue?**

18 A: Yes. Existing QF contracts will need to be renewed and nothing done in this case
19 should suggest or assume to the contrary. If an existing QF contract comes up for
20 renewal prior to Commission approval of a new methodology and new pricing, the
21 renewal should be approved at stipulation pricing for whatever firm or non-firm

1 deliveries may be offered by the QF at the time. Anything else would be unfair
2 and extremely detrimental to existing QF projects. For example, Tesoro opted for
3 a short-term non-firm contract for a portion of its expected QF output because the
4 project was new and uncertain. Everyone understood that the contract would be
5 extended or replaced at the end of the term. At that point, assuming no new
6 methodology has been approved prior to filing for a new or extended contract,
7 Tesoro should receive stipulation pricing for the entire amount of firm or non-firm
8 deliveries offered by Tesoro. Anything done or approved in these dockets should
9 assume such a result.

10 **Q: Do you have any comments on the issues that still confront the Task Force**
11 **and the need for a more permanent methodology to determine avoided costs?**

12 A: Yes, the public interest requires timely resolution of the ongoing QF methodology
13 and pricing disputes. There are other potential QF projects in the wings which
14 require prompt pricing, certainty and transparency. A reasonable but prompt
15 schedule should be set to determine the QF pricing methodology going forward.
16 A minimum requirement for any methodology ultimately adopted should be
17 prompt and meaningful access to all data and modeling used to determine pricing.
18 For example, if a Differential Revenue Requirement (DRR) method is
19 considered, PacifiCorp should be required to ensure meaningful access by
20 regulators and QF developers to all data and models, including funding of
21 appropriate training. This is the biggest drawback of the DRR; the model is

1 currently a black box - and a very complicated black box at that. In the Task
2 Force meetings, the Company indicated that only one employee at PacifiCorp is
3 currently capable of running the model. This is clearly unacceptable. The
4 Commission should not rely on such a model until it is independently verified and
5 can be run by other parties, including regulators and potential QF developers.
6 Training on such a model should be provided at the expense of the utility.

7 **Q. Does this conclude your testimony?**

8 A. Yes it does.