



State of Utah

DEPARTMENT OF COMMERCE
Committee of Consumer Services

To: The Public Service Commission of Utah

From: The Committee of Consumer Services
Dan Gimble, Chief of Technical Staff
Phil Hayet, Consultant
Cheryl Murray, Utility Analyst

Copies To: The Division of Public Utilities
Constance White, Director
William Powell, Acting Energy Manager

PacifiCorp
D Douglas Larson, Vice President of Regulation

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Subject: Committee of Consumer Services' Recommendations Regarding
PacifiCorp's Application for Approval of an Amendment to Its Power
Purchase Agreement with Sunnyside Cogeneration Associates
Docket No. 05-035-46

1 Background

On 20 June 2005 PacifiCorp filed an application with the Public Service Commission (Commission) for approval of a fourth amendment (amendment) to its power purchase agreement (agreement or contract) with Sunnyside Cogeneration Associates (Sunnyside or SCA). The original agreement was entered into on 30 January 1987, (Case No. 86-2018-01) and has been amended three times. The third amendment dated February 16, 1993, Docket No. 92-035-06 was approved by the Commission on 8 April 1993.

In 1993, under its 30-year term agreement, Sunnyside began supplying electricity to PacifiCorp through its waste-coal fired electric generating power plant, which is a qualifying facility (QF). Under the agreement Sunnyside sells energy to PacifiCorp and is paid based on an hourly calculation of the value of the energy that PacifiCorp avoids by not having to generate that energy itself or purchase it from others. The calculation is adjusted every six months. This method is referred to as the Realized Marginal Energy Cost or "RMEC" method. There has been an ongoing disagreement between Sunnyside and PacifiCorp (the parties) regarding the calculation of avoided energy costs using the RMEC method. The

fourth amendment resolves the dispute between the parties over the RMEC method and replaces it with what they describe as a superior method for determining avoided energy costs.

2 Recommendation

For the reasons described below, the Committee cannot at this time recommend that the Commission approve or disapprove the Fourth Amended contract.

3 Fourth Amendment Terms and Payment Methodology

The proposed amendment outlines the terms and methodology under which SCA will be paid for electricity power sales to PacifiCorp.

3.1 Contract Term

The contract will remain in effect until 31 August 2023 and can be renewed for additional five-year terms.

3.2 Payment Methodology

Under the fourth amendment the total volume of energy produced by SCA will continue to be separated into three categories: Base Energy; Additional Energy; and Excess Energy. However, payment for energy in each of these categories will be based on time-differentiated prices during the on-peak, off-peak and Sunday time periods. Subject to ceiling and floor provisions, Sunnyside will be paid for the energy produced in each category based on a percentage of the Dow Jones Palo Verde Firm Index for the period in which the energy is delivered.

For all Base and Additional Energy produced in the On-Peak period each month, the following calculation will be performed:

Monthly volume of Base or Additional energy

X 0.85

X Simple average of the monthly Dow Jones Palo Verde Electricity Price Index for Firm Daily On-Peak power

The same calculation is used for the Base and Additional energy produced in the Off-Peak and Sunday periods, but using the appropriate indices in those time periods. Next, a comparison of the rate (\$/MWh) computed above is made to the time-differentiated ceiling and floor prices that have been agreed to by PacifiCorp and Sunnyside, and that are included in Appendix L (floor prices) and Appendix M (ceiling prices) in the purchase power agreement. Should the calculated rate exceed the ceiling price, the payment price (\$/MWh) will be capped at the ceiling price. Likewise, should the calculated rate fall below the floor price, the payment price (\$/MWh) will be raised to the floor price.

Payment for Excess Energy will be priced at the lower of 1) \$10 per MWh, or 2) using the same formula as above, without consideration of a ceiling or floor price. The amendment makes no changes to the transmission loss provisions.

4 Analysis

The new pricing method is based on 85% of the average monthly Palo Verde on-peak and off-peak prices, and the amendment has minimum and maximum contract payment provisions.

To the detriment of customers, there may be times, especially during off-peak hours, when the floor price will be higher than PacifiCorp's avoided costs and Sunnyside would be paid above avoided costs. For example, during 2005 the minimum price that PacifiCorp must pay is \$26.04/MWh and \$33.14/MWh during the off-peak and on-peak hours respectively, yet there may be some hours in 2005 when PacifiCorp's actual avoided costs will be lower than these minimum rates.

To the benefit of customers, there may be periods when the ceiling price is below PacifiCorp's avoided costs, especially during on-peak hours. The maximum payments in 2005 that PacifiCorp will have to make will be \$32.31/MWh and \$41.82/MWh during the off-peak and on-peak hours respectively, yet there may be some hours in 2005 when PacifiCorp's actual avoided costs will be higher than these maximum rates.

In Docket No. 03-035-14 PacifiCorp testified that its 20-year levelized avoided energy costs are \$36.56/MWh. The 20-year levelized ceiling, 24-hour price for Sunnyside energy proposed in the amendment is \$42.60/MWh, which is 16.5% higher than PacifiCorp's most current calculation for avoided costs. PacifiCorp's proposed methodology in that Docket has not yet been accepted, as the Docket is currently open. Despite the fact that the price determined by the fourth amendment to the contract is above the number that appears in PacifiCorp's testimony in the avoided cost Docket, the new SCA contract terms appear to result in lower costs to the ratepayer than the old contract. The basis for this is that PacifiCorp conducted an analysis covering the historical period of March 2004 through February 2005, in which it compared the cost of the Sunnyside contract using the RMEC method to the cost that Sunnyside would have been paid had the terms of the amended contract been in place over that period. PacifiCorp estimated that ratepayers would have saved \$216,000 had the amended contract been in place during that historical period. (See Exhibit PacifiCorp BWG-1).

As an additional comparison, Sunnyside's amended contract is calculated based on 85% of the average monthly Palo Verde on-peak and off-peak prices, while previous energy contracts with US Magnesium, Kennecott, and Tesoro are based on 93% of Palo Verde, yet those contracts do not contain minimum and maximum payment provisions. However, the US Magnesium, Kennecott, and Tesoro QF contracts are for materially shorter terms and are for non-firm energy. Also, these contracts use an index that was a stipulated short term solution for a limited MW quantity for purchases from QF resources because an avoided cost calculation method had yet to be adopted by the Commission. Substituting an

index for a calculated avoided cost payment to a QF is not necessarily a reasonable estimate of the actual avoided cost. The Committee views substituting an index for a calculated avoided cost, in the case of SCA, as more for expedience and convenience. Accordingly, any long-term contract such as the subject of this docket must be carefully scrutinized for compliance with PURPA. Furthermore, any approved use of an index to determine PacifiCorp's avoided cost for the purpose of this agreement with SCA should disavow an index as being an acceptable substitute to calculating actual avoided costs for any other QF contract.

5 Accounting Treatment of the Agreement

In testimony requesting that the Commission approve the Fourth Amended Contract, PacifiCorp's witness Bruce W. Griswold discusses accounting standards based on Emerging Issues Task Force (EITF) 01-08, *Determining Whether an Arrangement Contains a Lease*, and Financial Accounting Standard (FAS) 13, *Accounting for Leases*. PacifiCorp concludes that the Fourth Amended contract must be treated as a capital lease. This designation on a net present value will increase the price paid to SCA by approximately \$3.9M per year above the avoided cost. PacifiCorp will include this amount in rates.¹ However, as discussed above, even with the cost of imputed debt the Company's analysis shows that ratepayers will pay less with the new contract than under the current RMEC method. (Exhibit PacifiCorp BWG-1).

PacifiCorp's agreement to ignore \$3.9 million of annual imputed debt is inconsistent with PacifiCorp's position on this issue described in testimony provided by Mahendra B. Shah in Docket No 03-035-14 regarding additional costs imposed by QF contracts. Mr. Shah states, "If the [*imputed debt*] cost is not borne by the QF, the cost will effectively be shifted to customers and result in compensation to the QF that exceeds the avoided cost. In that case, the PURPA ratepayer indifference standard will be violated."² By not reducing the avoided cost payment to account for the additional costs imposed by the Fourth amendment PacifiCorp violates the very principle it advocates in the avoided cost docket, the PURPA required ratepayer indifference standard.

While the Committee recognizes that this amendment ameliorates the harm imposed on ratepayers by the existing agreement, we are concerned that it does not meet the PURPA standard of ratepayer indifference. Unless PacifiCorp can satisfy the Commission that the history, circumstances and terms of the Fourth Amended contract justify its proposed treatment of imputed debt arising from this

¹ Direct Testimony of Bruce W. Griswold, Docket No 05-035-46, pgs 4 & 5.

² Direct Testimony of Mahendra B. Shah, Docket No 03-035-14, pg. 8, lines 171-174.

capital lease, then the Commission should order that the \$3.9 million annual charge be deducted from the payments made to the QF.³

6 Conclusion

Approval of the fourth amendment to the SCA contract will result in ratepayers paying less for power than under the current RMEC method. However, payments to SCA will be substantially higher than payments that would be derived using PacifiCorp's proposed avoided cost calculation in Docket 03-035-14 and therefore will not meet the PURPA standard of ratepayer indifference. The results of the analysis illustrates the importance of the Commission determination of an appropriate avoided cost methodology which is the subject of Docket No. 03-035-14. Using accurate avoided costs in future qualifying facilities contracts will help prevent ratepayers from being subject to inappropriately high prices over long contractual periods. Our neutrality is borne of our reservations about the contract price as a true avoided cost, and the \$3.9M debt imputation charge that PacifiCorp will not assign to SCA, and on the other hand, the fact that the new price is more favorable to consumers than the old price.

³ The Committee recognizes that there may be terms and conditions to the SCA contract that justify the Company not enforcing the debt imputation rule in this contract. For example the Company retains a perfected security interest and lien in the project that secures SCA's performance.