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Memorandum

To: Public Service Commission

From: Division of Public Utilities
Constance White, Director
Artie Powell, Acting Energy Manager
Andrea Coon, Technical Consultant

Subject: In the Matter of the Application of PacifiCorp for an Order Approving an Amendment to its Power Purchase Agreement with Sunnyside Cogeneration Associated: Docket No. 05-035-46

Date: August 22, 2005

Background

On June 21, 2005, PacifiCorp filed a proposed contract amendment for its contract with Sunnyside Cogeneration Associates (Sunnyside or SCA). In support of this proposal, PacifiCorp also filed testimony written by Bruce Griswold. Prior to the filing, on February 9, 2005, representatives for Sunnyside and PacifiCorp met with the Division of Public Utilities (Division) in order to explain the coming request for changes to the contract. Also on June 21, 2005, the Commission issued an Action Request to the Division. The following analysis and recommendation is submitted in response to the Commission's request.

Recommendation of Approval With Conditions

The Division recommends that the Commission approve the 4th Amendment to the Power Purchase Agreement between Sunnyside and PacifiCorp. We believe that it is a reasonable solution to the ongoing struggles between the two parties. We also believe that it should leave ratepayers indifferent at worst. There, the Division finds that the Amendment is in the public interest. The Division does, however, recommend that the Commission condition its approval upon: (1) an addition of language in section 2.1 requiring Commission approval of any contract extensions, and (2) consistent hours being established in sections 3.1(p) and 3.1(q).

Analysis

The Amendment filed before the Commission seeks to alter the currently active contract previously approved by the Commission as originally written and also as amended by Amendments 1-3. The Amendment currently under consideration does not extend the contract length or modify the capacity payments previously approved by the Commission. Instead, this Amendment is intended to change only the methodology used to determine the energy payments that will be paid for energy delivered from SCA to PacifiCorp. As such, the Division's analysis of this Amendment focuses on the proposed change in methodology.

The Amendment is broken down by section in order to identify the sections of the previously amended contract that are being altered. The entire contract, complete with all previous amendments, was not filed in conjunction with the Amendment. The entire contract was, however, provided to the Division during a meeting with the contracting parties.

Under the current contract, energy prices are calculated using a method known as the Realized Marginal Energy Cost (RMEC) method. This method uses a model to determine the marginal energy units and associated costs for each hour of the year. These costs are

then averaged over a six-month period and applied as the energy price for the following six months.

The new method of determining energy payments began by breaking the hours down into pieces that correspond with the published indexes available. That is, the pricing will now be based upon at what period of the day or week the energy is being delivered. The hours are generally broken into three pieces: on-peak hours, which comprise the period of 7 AM – 10 PM Monday through Saturday; off-peak hours, which comprise the period of 10 PM – 7 AM Monday through Saturday; and 24-hour, which comprises the period of Sundays and NERC holidays. This breakdown will allow each period to be tied to a market index specifically covering that period.

Once all of the monthly hours are broken into periods that correspond to an index, a simple average of the monthly index price is taken. The index that has been agreed to in this case is the Dow Jones Palo Verde index or a similar successor if required. The simple average is then multiplied by 0.85 (85%) to obtain an average price for each period.

Next, in order to mitigate market volatility, each period is assigned a floor and ceiling price. These pricing floors and ceilings recognize that energy delivered during the off-peak hours or on Sundays does not hold the same value, either on the market or to PacifiCorp, as does energy delivered on peak. In addition to the floors and ceilings above, any excess energy (energy that is above that anticipated in the contract as firm energy) delivered by SCA, is paid the lower of \$10/MWH or the rate obtained from the applicable index for the period in which the energy is delivered. This seems to acknowledge the fact that firm energy holds more value to PacifiCorp than does non-firm.

The Division is not convinced that a tie to a market index provides the most accurate valuation of PacifiCorp's avoided costs, but given the lack of a permanent methodology at this time believe that this method provides a reasonable valuation of PacifiCorp's avoided costs. We also believe that this method is considerably easier and less expensive to administer than the method currently in SCA's active contract. The Division is aware

that the struggles over the RMEC method have been going on since this QF began delivering power. The Division believes that enabling SCA to track payments in a straightforward manner is a step forward in promoting QF development. Ultimately, pricing of large QF's will be dealt with in Docket No. 03-035-14.

The Division has examined Mr. Griswold's analysis as provided in his testimony that shows that even given the cost of imputed debt for this contract, ratepayers should be no worse off using the index method than they were under the RMEC method. Although the Company has not included payment of imputed debt costs in Amendment 4, it is important to remember that this is an amendment to a current contract. If the other contracting party would not agree to the change due to imputed debt, then the choices open to PacifiCorp were to try to make changes that would benefit ratepayers, even without the debt adjustment, or to continue on with the contract in place as approved. The imputed debt issue is being considered in two current dockets, Docket No. 03-035-14, looking at debt as it concerns QFs, and Docket No. 05-035-47, looking at debt as it concerns resources acquired by means of an RFP. In addition, the Commission also set aside the debt issue for debate on a broader scale in its order for Docket No. 05-035-08 dated August 19, 2005. The Division feels that as the imputed debt issue is still an unresolved issue under investigation in other dockets, not collecting the debt cost from SCA in this Amendment is by no means a fatal flaw and should not be used as justification to reject the Amendment.

In addition to other possible benefits provided by this Amendment, it is the Division's understanding that the index provision in this amendment will end the legal action over the RMEC method. Given lower administrative costs as well as similar or lower rates paid to the QF, the new amendment could be beneficial to ratepayers. The Division is also going forward with an analysis in a related docket that preliminarily indicates an 85% of index price is not necessarily an unreasonable energy payment. Therefore, the Division is satisfied that although it is not necessarily a perfect methodology for calculating and paying avoided costs, the recommended methodology produces a satisfactory outcome.

There are, however, two small areas of concern to the Division in the Amendment. The first area is in section 2.1 with language allowing for contract extensions. This section does not outline that such modifications would need to be brought before the Commission for approval. The Division believes that this clarification is a necessary addition to the language of section 2.1. The second area of concern is a discrepancy in the hours of on peak and off-peak as described in sections 3.1(p) and 3.1(q). Although the Division agrees with the hour separation into on and off-peak, we believe that it is imperative to have consistency in the language in order to prevent future litigation as to intent of the language. Both of these issues have been brought to PacifiCorp's attention; PacifiCorp has agreed to make the alterations suggested. If the alterations are not made prior to the Commission order on this matter, the Division recommends that the Commission order the changes.

CC: Edward Hunter, Stoel Rives
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