State of Utah
Department of Commerce
Division of Public Utilities

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DIVISION PRUDENCE REVIEW OF PACIFICORP REC SALES AND AUDIT REPORT

PUBLIC COPY

To: Public Service Commission

From: Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Manager
Charles Peterson, Technical Consultant
Brenda Salter, Technical Consultant
Douglas Wheelwright, Utility Analyst

Date: September 14, 2012

Re: **Docket No. 12-035-68**, In The Matter Of The Application Of Rocky Mountain Power For Authority To Revise Rates In Tariff Schedule 98, Renewable Energy Credits Balancing Account, By Crediting Revenues Of Approximately $4.0 Million

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RECOMMENDATION (Approve rates as final)

Based upon the Division's prudence review and audit of PacifiCorp's efforts to sell its available Renewable Energy Credits (RECs), the Division recommends that the Commission approve the interim rates set under this docket as final.

ISSUE

On March 15, 2012, Rocky Mountain Power (Company) filled an Application to revise rates by $4.0 million in Schedule 98 that relates to the Company's renewable energy balancing account.

On May 30, 2012, the Commission issued a Report and Order (Order) establishing interim rates and directing the Division to perform an audit and to "examine all aspects of the Company operations pertaining to its REC revenue during the relevant period…."[1] In the hearing leading up to the Order, industrial intervenor group, UIEC, raised concerns that the Company was not optimizing the value of its REC assets. UIEC's concern is similar to the issue raised in the 2010 rate case Docket No. 10-035-124 by a witness for U.S. Magnesium, LLC.[2]

DISCUSSION

Division auditor Brenda Salter performed an audit which is attached as a separate document. The Division's audit found no material discrepancies in the Company's records of REC transactions. The Division has also investigated the Company's efforts to sell its available RECs during the calendar year 2011. As part of its investigation the Division reviewed documents designated by the Company as "highly confidential" at the Company's Salt Lake City offices, reviewed data requests submitted to the Company by UIEC, submitted its own data requests, and held a conference call with representatives of PacifiCorp.

In reviewing especially the Company's response to UIEC data request 1.7, the Division noted that the Company had generated about [redacted] potential RECs in 2011. Of this amount the Company reserved approximately [redacted] to satisfy its own state renewal portfolio standards (RPS), and had sold approximately [redacted] RECs. That apparently left nearly [redacted] RECs unsold; almost [redacted] of the total. The initial impression is that the Company has failed to market, at any price, [redacted] of the RECs it generated in 2011. At a minimum this creates the impression that the Company is less than aggressive in marketing its available RECs. The Division endeavored first to determine what the Company did to try to sell its RECs; second, if the amount sold was reasonable, and third, whether the price received was reasonable.

[1] Order page 4.
[2] See direct and surrebuttal testimony of U.S. Magnesium witness Roger J. Swenson; direct and rebuttal testimony of PacifiCorp witness Stefan A. Bird; and rebuttal testimony of Division witness Charles E. Peterson (DPU Exhibit 18.0).

The Division reviewed highly confidential documents that indicated that the Company bid into ten third party RFPs during 2011 to sell its RECs. In nine of the ten RFPs the Company bid fairly consistent prices and periods of around [redacted] One RFP was for the 2008-2011 time period and was for prices [redacted] The Company won only one RFP, which was at the higher price range. The Company told the Division that of its losing bids only one loss was "price-driven." In this case, the Company claims that feedback from the RFP issuer suggested that it was only slightly "out of the money," i.e. the Company offered to sell RECs at too high a price. In other instances the Company understood its failures to be based on the issuers looking for California-only generation sources, or in the case of some municipal entities, that the RFPs were essentially withdrawn due to on-going regulatory uncertainty.

The Company also issued two RFPs of its own to sell its available RECs. However, the Company reports that [redacted] The Company was able to sell [redacted] RECs through brokered transactions for an average price [redacted]

The Company also indicates that it is frequently in contact with (primarily) two brokers regarding the REC market and potential buyers of its RECs. The Company reports that its contacts with these brokers confirm that the market for RECs has largely dried up. The Company suggests that it is well known in the market place that PacifiCorp has RECs to sell. Furthermore, the Company has informed the Division that it has an employee whose principal job is to track the REC market and locate potential buyers for the Company's RECs.

The Company states that the data in the response to UIEC Data Request 1.7 are misleading as to the amount of RECs that are actually sellable. Of [redacted] unsold RECs in 2011, [redacted]

[redacted] are from hydro facilities that do not qualify under the California[3] Oregon,[4] and Washington[5] RPSs. The Company claims that because of this, these RECs are virtually unsellable at any price. RECs totaling [redacted] are from QFs that also do not qualify under the California RPS which makes their sellability uncertain as well.[6] The Company generated a small amount of RECs, about [redacted] from biogas and biomass that it also claims do not qualify under RPSs. However, the Division has not been able to verify that claim.[7] Finally the Company states that many potential REC products that it might be able to sell into California are not available to it because it cannot now dynamically schedule those RECs in California.[8] A recent article commented on the issue of dynamic scheduling:

> "To qualify, projects have to either connect directly to the state's [California's] grid or use what's called "dynamic transfer," a complicated process for moving renewable energy between grids. Because most Western grid managers are reluctant to use the process, though, energy development in most of the region is essentially cut off from the California market."[9]

The Division has been able to confirm that the RPSs in California, Oregon, and Washington likely exclude the RECs the Company generates from its hydro facilities and, in California, its QF purchases. Based upon the information available to it, the Division believes that of the approximately [redacted] unsold RECs created in 2011, only about [redacted] are eligible for

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[3] California's RPS allows for "Hydroelectric incremental generation from efficiency improvements" generally occurring after 2008. See California Energy Commission, "Renewable Energy Standard Eligibility Guide Book," August 2012, pages 19-25, http://www.energy.ca.gov/2012publications/CEC-300-2012-006/CEC-300-2012-006-CMF.pdf

[4] Hydro power in Oregon only qualifies if it is the result of efficiency improvements after January 1, 1995. See SB 838 (2007). http://www.leg.state.or.us/07reg/measures/sb0800.dir/sb0838.a.html.

[5] Washington RPS allows for hydro or hydro efficiency improvements completed after March 31, 1999. See Initiative 937, pages 2-3, http://www.secstate.wa.gov/elections/initiatives/text/i937.pdf

[6] RECs from QF contracts entered into after January 1, 2005 are ineligible in California, California Energy Commission, Op. Cit. page 69.

[7] The California Commission has suspended biogas from eligibility pending further rule making. California Energy Commission, Op. Cit. page 16.

[8] Dynamic Scheduling refers to the ability of a Balancing Authority to dynamically make load and generation assignments on a real time basis through the use of electronic interconnections.

[9] Ernst, Steve "California clean energy rules may impede imports from rest of West," *High Country News,* May 28, 2012, http://www.hcn.org/issues/44.9/the-fading-arizona-town-of-gila-bend-bets-big-on-solar/california-clean-energy-rules-may-impede-imports-from-rest-of-west/print_view

sale in California. Given the additional restrictions on out of state RECs in California, it appears unlikely that the Company can sell these RECs there.

The Division also considered the potential for the sale of additional RECs to Nevada where the Company has previously been able to make sales. Based upon information provided by NV Energy, the primary energy supplier in Nevada, it appears that that company will not need to make additional market purchases of RECs at least through 2015.[10]

In order to come to some independent evaluation of the REC market, the Division has compiled information on REC prices compiled by SNL. DPU Exhibit 1 graphically sets forth the trend in these prices throughout 2011. The prices compiled by SNL do not necessarily represent transaction prices, but may only represent offers to sell. DPU Exhibit 1 gives indicative prices in California of around $8.00 per unbundled REC during the first half of 2011; however, in the second half of the year the prices trend steadily downward to about $2.00. It must be emphasized that these prices do not necessarily represent actual transaction prices nor is there volume information available. The Division interprets this price data to indicate that roughly during the first half of 2011 there was some reasonable amount of demand for RECs. After around mid-year whatever demand for RECs there had been quickly dried up. SNL data for 2012 shows that the relatively low prices for California RECs continue, indeed the indications are for prices around $1.00; again suggesting little demand.

The Division also has reviewed popular media articles that comment on the state of the REC market in California that are also suggestive that little demand exists for PacifiCorp's RECs. In a recent edition of *High Country News* the following comment is noteworthy:

> "The problem lies with what's known as Category 1 contracts, the main "bucket" of power that will be used to meet 75 percent of California's renewable needs. To qualify, projects have to either connect directly to the state's grid or use what's called "dynamic transfer," a complicated process for moving renewable energy between grids. Because most Western grid

[10] NV Energy, pdf presentation, March 2011, a copy is in the Division's possession.

> managers are reluctant to use the process, though, energy development in most of the region is essentially cut off from the California market. Meanwhile, the state's rules for qualifying for Category 1 have not been set, another major obstacle for out-of-state projects." (6th paragraph)[11]

Another article from 2011, from a trade journal, the *California Current*, includes the following quotations:

> Now, however, recent amendments to SB1x-2 add: "The program objective shall be to increase, in the near term, the quantity of California's electricity generated by renewable electrical generation facilities located in this state…." (seventh paragraph from the top)
>
> "So, my initial assessment of the market impacts of the prospective 33 percent renewables portfolio standard measure suggests a minimal change. Virtually no new development will occur beyond what the utilities are already contracting for until after 2016. Out-of-state developers counting on the California market will find little opportunity for selling renewable credits on a long-term basis." (second to last paragraph)[12]

Given the information available to it, the Division believes that the hydro and QF RECs are of little value and are probably unsellable as the Company claims. The SNL price evidence and anecdotal evidence from the news media also supports the Company's position that the market for RECs in the West has probably dried up, at least since the latter half of 2011. Due to the Division's current understanding of the California REC regulatory scheme, it is plausible that California utilities are primarily interested in RECs generated within that state making it additionally difficult for PacifiCorp to sell its RECs into that market. Likewise, California municipalities have been grappling with regulatory uncertainty throughout 2011. Finally, to date, the Division has not come across any information that suggests that the Company should have been able to sell more of its RECs with the sole exception that the SNL data indicates that there was some level of demand for RECs in the first part of 2011. However, given the

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[11] Ernst, Op. Cit.
[12] O' Donnell, Arthur, "GUEST JUICE: The 33% Solution & Energy Market Impacts," *California Current*, March 4, 2011. http://www.cacurrent.com/storyDisplay.php?sid=5195

limitations of the SNL data, no definite conclusions can be reached. Too, as the Division noted earlier, PacifiCorp was in fact able to sell some of its RECs in 2011 and receive [redacted]

CONCLUSION

The Division endeavored first to determine what the Company did to try to sell its RECs; second, if the amount sold was reasonable, and third, whether the price received was reasonable. The Division has determined that the Company tried to sell its RECs through RFPs and broker transactions, and the Company has an employee whose primary job is to sell RECs. Of the approximate [redacted] potential RECs that the Company generated in 2011, it was unable to sell or otherwise account for [redacted] Based on stated Company policy to hold [redacted] of its obligations [redacted] in reserve, it probably would have withheld about [redacted] in order to be assured of its ability to cover its obligations.[13] Given that the evidence suggests that the REC market has dried up, the Division cannot conclude that the Company could have reasonably been expected to sell any of the unsold RECs. The prices for the RECs the Company did sell appear to be in line with the market data the Division has through SNL.

The market for RECs is largely opaque to outsiders making it difficult for the Division to independently confirm many of the representations of the Company. However, to the extent the Division can independently check those representations, the information available tends to support the Company's contentions. Furthermore, the Division has not turned up any material evidence that contradicts the Company's claims about the REC market. Therefore, with these limitations in mind, the Division finds no evidence of imprudence in the Company's marketing of its RECs.

As described in the attached audit report, the Division found no material exceptions in the Company's books and records.

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[13] Direct Testimony of Stefan A. Bird, Docket No. 10-035-126, January 2011, pages 3-4. Rebuttal Testimony of Stefan A. Bird, Docket No. 10-035-126, pages 10-11.

Attachments

CC:

Dave Taylor: Rocky Mountain Power

Stacey Kusters: PacifiCorp Energy

Michele Beck: Office of Consumer Services

Robert Reeder, William Evans, and Vicki Baldwin: attorneys for UIEC