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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE COMMISSION'S REVIEW OF PURPA QF CONTRACT PROVISIONS INCLUDING THE SURROGATE AVOIDED RESOURCE (SAR) AND INTEGRATED RESOURCE PLANNING (IRP) METHODOLOGIES FOR CALCULATING PUBLISHED AVOIDED COST RATES.	)	**CASE NO. GNR-E-11-03** **STAFF LEGAL BRIEF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its attorney of record, Kristine A. Sasser, Deputy Attorney General, and in response to the Notice of Scheduling issued on November 2, 2011 (Order No. 32388), submits the following legal brief.

BACKGROUND

On November 5, 2010, Idaho Power Company, Avista Corporation, and PacifiCorp dba Rocky Mountain Power filed a Joint Petition requesting that the Commission initiate an investigation to address various avoided cost issues related to the Commission's implementation of PURPA. The Commission first examined eligibility to published avoided cost rates. As a result of the evidence and arguments presented, the Commission lowered eligibility to published avoided cost rates to 100 kW for wind and solar QFs while it continued its investigation.

In its second phase, the Commission explored whether it was just and reasonable to utility customers and in the public interest for large projects to disaggregate into smaller QF projects in order to be eligible for published avoided cost rates that may not be an accurate reflection of the utility's true avoided costs for such projects. Ultimately, the Commission determined that any attempt to implement criteria in an effort to prevent disaggregation would be met by attempts to circumvent such criteria. The economic motivation for such action was too strong. The Commission emphasized that PURPA and Idaho's published rate structure were never intended to promote large scale wind and solar development to the detriment of utility customers. The Commission determined that allowing the current trend to continue could cause customers to pay for resources at an inflated rate and, potentially, before the energy is actually needed by the utility to serve its customers. The Commission stated that such a result is clearly not in the public interest.

In order to ensure that the Commission is approving just and reasonable avoided cost rates, the Commission initiated a third phase of this proceeding to allow the parties to investigate and analyze both the SAR methodology and the IRP methodology. The Commission is now in the third phase of its investigation. The scope of the Commission's inquiry also includes (but is not limited to) considerations regarding the dispatchability of varying resources, curtailment options, integration costs, renewable energy credits, delay security and liquidated damages, timing and schedule of negotiations, and contract milestones. Direct testimony and rebuttal testimony has been filed. A technical hearing on all issues is scheduled to begin on August 7, 2012.

Staff intends for this legal brief to address issues that do not lend themselves to testimony by expert witnesses. The absence of a stated legal argument regarding any particular issue should not be construed as acquiescence of positions already taken by Commission Staff in prefiled testimony or to be taken at hearing.

ARGUMENT

A. Renewable Energy Credits

Congress passed the Public Utility Regulatory Policies Act (PURPA) in 1978 in response to the national energy crisis. Its purpose was to lessen the country's dependence on foreign oil and to encourage the promotion and development of renewable energy technologies as alternatives to fossil fuels. To encourage the development of renewable generating facilities, Section 210 of PURPA requires that electric utilities purchase power produced by co-generators or small power producers that obtain qualifying facility (QF) status under PURPA. 16 U.S.C. § 824a-3(b); 18 C.F.R. § 292.303(a). This mandatory purchase requirement is often referred to as the "must purchase" provision of PURPA and its implementing regulations as promulgated by FERC.

Under the must purchase provision, the rate a QF is to receive for the sale of its power to a utility is generally referred to as the "avoided cost" rate. The avoided cost rate represents the incremental cost to the purchasing utility of power which, but for the purchase of power from the QF, such utility would either generate itself or purchase from another source. *Rosebud Enterprises v. Idaho PUC*, 128 Idaho 624, 917 P.2d 781 (1996); 18 C.F.R. § 292.101(b)(6). The PURPA avoided cost rates are intended to compensate the QF only for the purchased power. Avoided cost rates "are not intended to compensate the QF for [RECs]." *Morgantown Energy Associates*, 139 FERC 61,066 at ¶ 47 (April 24, 2012); *American Ref-Fuel Company*, 105 FERC 61,004 (Oct. 1, 2003); *Xcel Energy Services v. FERC*, 407 F.3d 1242 (D.C. Cir. 2005). "PURPA . . . does not address the ownership of RECs." *American Ref-Fuel*, 105 FERC at ¶ 23.

Issues regarding REC ownership have generally arisen since states began adopting renewable portfolio standard (RPS) programs over the last 15 years. *American Ref-Fuel*, 105 FERC at ¶ 23; *Xcel Energy*, 407 F.3d at 1242; *In Re Ownership of Renewable Energy Certificates*, 913 A.2d 825 (N.J. App. Div. 2007). FERC observed in 2003 that "RECs have been created in recent years by State programs typically designed to promote increased reliance on renewable energy resources." *American Ref-Fuel*, 105 FERC at ¶ 23. RECs "exist outside the confines of PURPA. . . . <u>States</u>, in creating RECs, <u>have the power to determine who owns the RECs</u> in the initial instance, and how they may be sold or traded; it is not an issue controlled by PURPA." *Id.* at ¶ 23 (emphasis added); Order No. 29480; *Idaho Wind Partners*, 136 FERC 61,174 at n.10 (Sept. 15, 2011). "[I]nsofar as RECs are state-created, different states can treat RECs differently." *American Ref-Fuel*, 107 FERC 61,016 at n.4.

Clearly, PURPA and FERC have left a determination regarding ownership of RECs to the states. Unlike many of our surrounding states, the Idaho Legislature has neither adopted an RPS, nor created a state REC program. 2012 Idaho Energy Plan § 3.2.2 at 78 (Jan. 10, 2012). This Commission has, on numerous occasions, encouraged utilities and QFs to negotiate the issue of REC ownership. However, there is no Commission Order or state law that currently dictates which entity should own the RECs produced when a QF obligates a utility to purchase its energy. Therefore, there is no legal impediment to determining who appropriately owns renewable energy credits.

The Idaho Legislature has delegated authority to the Public Utilities Commission "to deal broadly with existing and future rates, rate schedules and contracts affecting rates." *Washington Water Power Co. v. Kootenai Environmental Alliance*, 99 Idaho 875, 880, 591 P.2d 122, 127 (1979); *See generally Idaho Code* §§ 61-502 and 503. The Idaho Supreme Court has recognized "the difficulty of having the legislature regulate intelligently the rates, service and other matters which need regulation in connection with utility corporations." *Id.* at 882. The expertise, technical skill and constant attention necessary to regulate utilities "was held to be a strong argument for the delegation of the legislative authority to a commission." *Id.* Authority to determine ownership of RECs lies with this Commission because the consequences of such a decision are inextricably tied to existing rates, future rates and contracts affecting rates. Specifically, the costs associated with QF contracts are directly recovered from ratepayers through the retail rates charged by utilities and, although REC ownership is not a matter controlled by PURPA, RECs have become an inescapable element of negotiations between utilities and QFs in Idaho. Furthermore, with its expertise, technical skill and ongoing oversight of regulated utilities and QF transactions, the Commission is in the best position to weigh and analyze the consequences of REC ownership to the ratepayers, the utilities and the renewable industry. The Idaho Commission is well-versed in PURPA and FERC regulations and adept at appropriately administering federal and state law. Consequently, the Commission is the appropriate forum for a determination of REC ownership.

It is reasonable and just to conclude that RECs should be owned by the utility that purchases the energy from the QF. But for PURPA and its requirement that utilities purchase the renewable energy that a QF produces, the QF would not exist. If a QF strips the renewable attributes prior to conveying the energy to a utility, then the basis for which the QF initially received its status and gained its authority to sell no longer exists. Said another way, if the utility is being compelled to purchase based on the energy being renewable, then the renewable status should remain with the energy purchased by the utility. Moreover, an environmental attribute is an intangible characteristic of the energy generated by a renewable energy facility, not a characteristic of the facility itself.

The public interest also requires that the RECs belong to the utility. QFs receive guaranteed recovery at a guaranteed rate for every kilowatt they produce. Because of PURPA, the utility must purchase the energy that a QF generates. PURPA was intended to reduce the country's dependence on fossil fuels by encouraging renewable technologies and cogeneration. *Southern Cal. Edison Co., San Diego Gas & Electric*, 71 FERC ¶ 61,269 at 62,079 (1995). However, "the intention was to make ratepayers indifferent as to whether the utility used more traditional sources of power or the newly-encouraged alternatives." *Id.* at 62,080. The federal government did not intend to create an environment in which renewable energy producers thrive to the detriment of the utilities' ratepayers – hence, the avoided cost requirement. Notwithstanding the fact that Idaho does not currently have an RPS, if the utility is purchasing renewable energy, then the utility should be able to claim the renewable energy in its portfolio. If a utility must purchase QF power without the renewable attributes attached, but is held to an RPS, then the utility would be required to purchase or obtain additional RECs at the expense of the ratepayer. It is illogical, unreasonable and unjust for ratepayers to pay for what is, in reality, renewable energy through a must-purchase obligation under PURPA, not get the benefit of the renewable attribute that is produced with each kilowatt, and then be required to pay through rates <u>again</u> when the utility purchases RECs to meet an RPS.

Finally, because RECs exist outside the confines of PURPA, a utility cannot be accused of failing to negotiate in violation of PURPA when the QF and utility are at an impasse regarding REC ownership during contract negotiations. PURPA does not require that the utility negotiate REC terms into a power purchase or firm energy sales agreement.

B. Curtailment – Proposed Schedule 74

As part of its testimony in this case, Idaho Power Company submitted tariff Schedule No. 74, through which Idaho Power states that it wishes to reiterate Section 292.304(f) of FERC's PURPA regulations. FERC's regulation provides in relevant part:

> Any electric utility which gives notice pursuant to paragraph (f)(2) of this section will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

18 C.F.R. § 292.304(f). FERC explained that

> This section was intended to deal with a certain condition which can occur during light loading periods. If a utility operating only base load units during these periods were forced to cut back output from the units in order to accommodate purchases from qualifying facilities, these base load units might not be able to increase their output level rapidly when the system demand later increased. As a result, the utility would be required to utilize less efficient, higher cost units with faster start-up to meet the demand that would have been supplied by the less expensive base load unit had it been permitted to operate at a constant output. The result of such a transaction would be that rather than avoiding costs as a result of the purchase from a qualifying facility, the purchasing electric utility would incur greater costs than it would have had it not purchased energy or capacity from the qualifying facility.

Order No. 69 (FERC Stats. & Regs. ¶ 30,128 at 30,886 (1980). FERC further elaborated that

> [S]uch periods must be due to operational circumstances. The Commission does not intend that this paragraph override contractual or other legally enforceable obligations incurred by the electric utility to purchase from a qualifying facility. In such arrangements, the established rate is based on the recognition that the value of the purchase will vary with the changes in the utility's operating costs. These variations ordinarily are taken into account, and the resulting rate represents the average value of the purchase over the duration of the obligation. The occurrence of such periods may similarly be taken into account in determining rates for purchases.

Id. (Emphasis added.) In response to concerns that a utility would abuse this ability to self-generate rather than purchase from a QF, FERC clarified that its curtailment provision only applied during "light loading" periods where, due to operational circumstances related to base load generation, the true avoided cost rate would be negative. *Id.* Thus, curtailment is not available to a utility at any point that it might be able to generate less costly power, but rather only when specific operational circumstances arise. Despite representations by intervenors to the contrary, Staff acknowledges that curtailment under FERC regulations is not appropriate for general economic reasons.

No party disputes that 18 C.F.R. § 292.304(f) allows for curtailment under certain circumstances. The debate arises around what specific circumstances were contemplated by FERC – and whether the FERC curtailment regulation can be applied to existing contracts. As clarified by FERC in Order No. 69, if base load units would have to be cut back in order to accommodate purchases from QFs, but the base load units could not ramp-up quickly enough to meet subsequent system demand and the utility is put in a position of using higher cost, less efficient units to meet load, curtailment is authorized. The justification behind FERC's curtailment provision is obvious: PURPA intended that ratepayers be indifferent to the source of a utility's energy. If curtailment of QFs under the above-stated operational circumstances were not permitted, ratepayers would be subsidizing QFs during minimum load periods by bearing higher costs in order to prevent QF curtailment. FERC has repeatedly stated that, in promoting greater fuel diversity, "Congress was not asking utilities and utility ratepayers to pay more than they otherwise would have paid for power." *Southern Cal. Edison Co., San Diego Gas & Electric*, 71 FERC ¶ 61,269 at 62,079 (1995). Asking ratepayers to subsidize QFs would be contrary to PURPA and in direct violation of FERC regulations.

Because the authorization to curtail during certain light load periods is provided for in FERC regulations, the authority applies to all contracts – new and existing – despite the fact that existing contracts may not expressly state the curtailment provision. "Existing law becomes part of a contract, just as though the contract contains an express provision to that effect, unless a contrary intent is disclosed." *Primary Health Network, Inc. v. Idaho Dept. of Administration*, 137 Idaho 663, 666, 52 P.3d 307, 310 (2002). "Extant applicable law is part of every contract in this state as if it were expressly cited or its terms incorporated in the contract. . . . A contractual adjustment of rights contrary to law must be clearly expressed in the agreement if applicable law is not to be applied." *Public Service Co. of Oklahoma v. Oklahoma Corp. Commission*, 115 P.3d 861 at 884 (2005). Consequently, contracts entered into pursuant to PURPA and corresponding FERC regulations assume those regulations as conditions. *Id.* Moreover, the majority of QF developers now building projects in Idaho are sophisticated parties. These QFs should reasonably be expected to know, understand and comply with existing PURPA law and FERC regulations that impact their facilities whether or not such terms are expressly provided for in their contracts.

"[T]he provisions of § 292.304(f) remain available to a utility even if its terms are not expressly included in the power sales agreement, *but its provisions may not be utilized by the utility if operational circumstances have already been taken into account in calculating the utility's avoided costs.*" *Id.* (emphasis in original). Several witnesses to this case assume that the operational circumstances contemplated by FERC that would allow for curtailment are already considered within the calculations of Idaho's avoided cost methodologies. However, Commission Staff witness Rick Sterling maintains that "Idaho's published avoided cost rates <u>do</u>

not already reflect the variations in the value of the purchase in the lower overall rate during the specific low loading scenarios when 304(f) is clearly intended to apply." Sterling Rebuttal at 5 (emphasis in original). Witness Sterling explains that the SAR methodology (used for computing published avoided cost rates) is based solely on the estimated cost of building and operating a combined-cycle combustion turbine resource – the surrogate avoided resource. The methodology assumes that the resource will be operated during all hours that it is available. *Id.* at 6. Because the low load operational circumstances contemplated by FERC have not historically been taken into account when calculating avoided cost rates in Idaho, the provisions of 18 C.F.R. § 292.304(f) would apply to such contracts.

Idaho Power states that its proposed tariff governs operational dispatch of QFs, including curtailment in certain circumstances as delineated by FERC. Specifically, the Company maintains that Schedule 74 would establish rules under which Idaho Power could curtail certain QFs if, due to operational circumstances, purchases from the QF would otherwise require the Company to dispatch higher cost, less efficient resources to serve system load or to make base load resources unavailable for serving the next anticipated load.

In its testimony addressing the proposed tariff Schedule 74, Idaho Power states:

> The Company's proposal will relieve the Company of its obligation to purchase energy from PURPA generators during low loading periods when the Company is operating only base load resources and would be forced to cut back output from those resources in order to accommodate unscheduled QF energy purchases. Because the Company's coal units have slow, gradual ramp times for them to reach full generating capacity, backing down such base load units too much to accommodate QF purchases will impact their ability to come back to full generating capacity to meet system load. If this were to occur, Idaho Power would be in the position of dispatching higher costs resources, such as the Company's natural gas peaker plants or more expensive market purchases, to meet variations in system load. This is exactly the type of scenario under which the FERC Rule was meant to apply and why Idaho Power is requesting authority from the [Idaho PUC] to implement it.

Direct Testimony of Tessia Park at pp. 18-19 (emphasis added). As long as the Company's Schedule 74 is modeled after the FERC regulation and does not expand the parameters under which curtailment is authorized, Idaho Power's desire to implement a tariff that sets out a procedural framework for such curtailments is entirely consistent with PURPA and FERC regulations.

Increasing amounts of intermittent, must-purchase generation will, inevitably, increase the frequency of circumstances within which curtailment will be necessary because base load units can only be backed down to a certain degree and a utility will always experience lighter loads. Even a portfolio with no intermittent generation will require that some plants be curtailed as load varies. FERC provided an exception with 18 C.F.R. § 292.304(f) to the PURPA requirement that utilities purchase the entire output of QFs. This provision would be rendered meaningless unless a utility is actually permitted to cease purchasing QF generation during a period in which operational circumstances exist.

Respectfully submitted this 20th day of July 2012.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 20TH DAY OF JULY 2012, SERVED THE FOREGOING **STAFF LEGAL BRIEF,** IN CASE NO. GNR-E-11-03, BY E-MAILING A COPY THEREOF TO THE FOLLOWING:

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