Service Date: January 9, 1991

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the Petition of the Montana Power Company (MPC) and Billings Generation, Inc. (BGI) to Determine the Rates and Conditions of a Power Purchase Agreement Between the Parties.	)	UTILITY DIVISION
IN THE MATTER OF the Complaint of F. Lee Tavenner.	)	
IN THE MATTER OF the Montana Power Company's 1990-1991 Avoided Cost Compliance Filing (filed July 11, 1990).	)	DOCKET NO. 90.8.51 ORDER NO. 5506a

FINAL ORDER

APPEARANCES

FOR THE PETITIONERS/RESPONDENT:

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FOR THE COMPLAINANT/INTERVENOR:

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FOR THE INTERVENOR:

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FOR THE COMMISSION:

Robin McHugh, Staff Attorney
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BEFORE:

HOWARD L. ELLIS, Chairman
DANNY OBERG, Vice Chairman
JOHN B. DRISCOLL, Commissioner
REX MANUEL, Commissioner
WALLACE W. "WALLY" MERCER, Commissioner

I. INTRODUCTION AND BACKGROUND

On December 19, 1989 the Montana Public Service Commission (Commission) received a complaint from F. Lee Tavenner against the Montana Power Company (MPC). The complaint was designated Commission Docket No. 89.12.57. On January 30, 1990 the Commission received an amended complaint from Mr. Tavenner. Pursuant to ARM 38.2.2104 both the complaint and the amended complaint were noticed to MPC. MPC answered the amended complaint on February 15, 1990 and asked that all relief asked for by Mr. Tavenner be denied and the complaint be dismissed.

On July 11, 1990 MPC filed its 1990-1991 avoided cost compliance filing. The filing was made pursuant to Commission Order Nos. 5091c and 5360d, and pursuant to Commission rule ARM 38.5.1905.

On August 28, 1990 MPC and Billings Generation, Inc. (BGI) petitioned the Commission, pursuant to §§ 69-3-603 and 604, MCA, to determine the rates and conditions of a power purchase agreement. BGI is a qualifying facility (QF) pursuant to §§ 201 and 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA). BGI intends to build a power plant in Billings and to sell the power to MPC under long-term contract.

On September 17, 1990 the Commission determined that the issues raised by the complaint of F. Lee Tavenner, the 1990 MPC avoided cost compliance filing, and the joint petition of MPC and BGI should be resolved in a single proceeding. Therefore, the Commission vacated Docket No. 89.12.57 and decided to process the complaint of Mr. Tavenner in Docket No. 90.8.51. See Notice of Prehearing Conference, Docket No. 90.8.51, September 21, 1990. On October 18, 1990 the Commission granted intervention in all phases of this Docket to F. Lee Tavenner and the Montana Consumer Counsel (MCC). See Notice of Staff Action, Docket No. 90.8.51, October 19, 1990. On October 3, 1990 the Commission issued Procedural Order No. 5506 that established a schedule for discovery and prefiled testimony. On November 1, 1990 the Commission issued a Notice of Public Hearing. Hearing was held at the Commission offices on November 29 and November 30, 1990.

At the conclusion of the hearing the parties agreed to a briefing schedule. Opening briefs and reply briefs were received from all parties.

II. THE MPC/BGI PETITION

As noted, MPC and BGI filed a joint petition with the Commission pursuant to §§ 69-3-603 and 604, MCA. This is the first such petition processed by the Commission. Section 69-3-603, MCA, reads as follows:

> **Required sale of electricity under rates and conditions prescribe by commission**. (1) If a qualifying small power production facility and a utility are unable to mutually agree to a contract for the sale of electricity or a price for the electricity to be purchased by the utility, the commission shall require the utility to purchase the electricity under rates and conditions established under the provisions of subsection (2).
>
> (2) The commission shall determine the rates and conditions of the contract upon petition of a qualifying small power production facility or a utility or during a rate proceeding involving the review of rates paid by a utility for electricity purchased from a qualifying small power production facility. The commission shall render a decision with 120 days of receipt of the petition or before the completion of the rate proceeding. The rates and conditions of the determination shall be made according to the standards prescribed in 69-3-604.

MPC and BGI were able to mutually agree to a price for the electricity to be purchased by MPC. They were unable to agree to a certain condition of the power purchase agreement. Therefore, in this proceeding the Commission will address the disputed condition in the agreement and will also determine the reasonableness of the rates established in the agreement.

A. THE REGULATORY OUT CLAUSE

The disputed issue presented to the Commission by BGI and MPC is whether "regulatory out" language should be allowed in the power purchase agreement. The disputed language is at Section 29 of the agreement and is attached to this Order as Appendix A. In summary, the regulatory out language will allow MPC to adjust its payments to BGI if the Commission disallows in rates some or all of the cost of those payments.

MPC contends that regulatory out language is necessary in order to protect its shareholders from the risk of regulatory disallowance. MPC refers to two recent decisions to support its concern about regulatory disallowance: 1) Commission Interim Order No. 5465a (and Order on Reconsideration No. 5465b) in Docket No. 90.3.17; and 2) Montana-Dakota Utilities Co. v. Montana Department of Public Service Regulation, et al., 47 St. Rptr. 1351, a 1990 Montana Supreme Court decision. In addition, MPC indicates that the recommendations of the Conservation and Least Cost Planning Committee, submitted to the Commission and MPC on October 16, 1990, raise concerns about regulatory disallowance. BGI argues that the regulatory out language should not be included in the power purchase contract because it makes the project difficult, if not impossible, to finance. BGI states that it may be able to finance the project, even with regulatory out language, if the Commission determines the rates. MPC responds that the project is financeable with regulatory out language, though financing may be more expensive. MCC, through witness Dr. John Wilson, recommends that regulatory out language be included only for the anticipated 20 year financing period of the 35 year contract. MCC also argues, in his post-hearing brief, that the inclusion of regulatory out language should depend on who is bearing the cost of the risk of regulatory disallowance. If BGI's avoided cost rates are calculated using MPC's cost of capital, a cost that includes the risk of regulatory disallowance, then regulatory out language is appropriate because BGI will be paid to take the risk of disallowance. If, on the other hand, BGI is not paid for the risk of disallowance, "then BGI's avoided cost rates should be calculated using a regulatory risk free capital cost and ratepayers should not be charged for the non-existent risk of regulatory disallowance." Brief of Montana Consumer Counsel, pp. 4-5.

The Commission's position on this issue is very similar to that of the Pennsylvania Commission in Re Pennsylvania Electric Company, 89 PUR 4th 402 (1988), a case cited by both MPC and BGI. In Pennsylvania Electric the Pennsylvania Electric Company filed a petition with the Pennsylvania Commission for approval of rate recovery of amounts to be paid to a QF under the terms of a power purchase agreement. The power purchase agreement included regulatory out language. The QF intervened in the proceeding in support of the Pennsylvania Electric Company. In addition, several other persons intervened out of concern that the Pennsylvania Commission might indicate in its decision that it is appropriate for utilities to insist on regulato ry out language before entering into a long-term power purchase agreement with a QF.

The Pennsylvania Commission noted that the regulatory out language issue "has arisen due to the perceived risk that this Commission, after reviewing and approving rate recovery of costs paid under a utility/QF agreement, could in the future 'second-guess' its prior order and disallow some portion of the costs previously approved for rate recovery." Id. at 405. The Pennsylvania Commission characterized the reaction to this perceived risk as a game of hot potato between utilities and QFs as each tries to force the other to bear the risk. The Pennsylvania Commission summarized its position as follows: "Our disposition of the regulatory out clause is relatively simple because in our view the perceived risk that we would second-guess a previously approved QF contract is nonexistent." Id.

Like the Pennsylvania Commission, this Commission finds that once it has duly determined the rates of a long-term power purchase contract between a QF and a utility, it will not revisit that determination based on changed circumstances. Section 210 of PURPA requires electric utilities to purchase power from certain qualifying facilities (QFs). See 16 USC § 824a-3 (1982). Rules implementing PURPA have been adopted by the Federal Energy Regulatory Commission (FERC) at 18 CFR, Part 292. The Commission has adopted and incorporated by reference 18 CFR, Part 292, and has adopted its own rules implementing PURPA. See ARM 38.5.1901-1908. In addition, Montana has passed a "mini-PURPA" that addresses the purchase of electricity by utilities from small power production facilities. See 69-3-601-604, MCA.

The Commission finds that it is the clear import of PURPA, the rules implementing PURPA, and the Montana "mini-PURPA," that QFs and utilities can enter into long-term power purchase agreements at negotiated rates. Those rates are subject to review and must be just and reasonable. In this context "just and reasonable" means at or below the avoided cost to the utility. See 18 CFR § 292.304(b)(2). When rates are determined just and reasonable, either through a process like this or during a rate case where utility QF costs are considered, then those rates are fixed for the term of the contract. The determination of just and reasonable rates is based on consistent criteria for establishing utility avoided costs, criteria defined by Commission rule, and the orders in effect at the time rates are developed. It is true that avoided costs established for a long-term power purchase agreement may be higher or lower than the actual utility avoided costs during the out years of the agreement. A change in the actual avoided costs will mean that ratepayers will either benefit, or will be harmed by the power purchase, depending on whether actual avoided costs at the time of delivery are higher or lower than the avoided costs initially calculated. However, this self-evident observation does not support the conclusion that this Commission will disallow QF power purchase costs based on changed circumstances.

The Commission finds that this position is supported by both federal and state law. FERC rule reads:

> In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

18 CFR § 292.304(b)(5). This language indicates that FERC recognizes that estimated avoided costs may differ from actual avoided costs at the time of delivery, but that the encouragement of QF power under long-term contracts requires rates that the contracting parties can rely on. Similarly, § 69-3-604(2), MCA, reads, "Long-term contracts for the purchase of electricity by the utility from a qualifying small power production facility shall

be encouraged in order to enhance the economic feasibility of qualifying small power production facilities." The Commission finds that for it to contend that QF power costs can be disallowed based on changed circumstances would not encourage long-term contracts and would, therefore, arguably be in violation of Montana law.

MPC's concern that once the BGI rates are determined, the BGI power purchase costs may be disallowed by this, or a future Commission, is unwarranted. No decision by this Commission or by the Montana courts supports such a concern. Therefore, MPC's insistence on regulatory out language as a necessary precaution is misplaced. Insistence by utilities on the inclu sion of regulatory out language would likely discourage long-term contracts for QF power. Consequently, the Commission does not favor such language and finds that it must be deleted from the agreement under review.

B. DETERMINATION OF RATES

Background: Docket No. 84.10.64, Order No. 5091c

The following findings review the relevant decisions in Order No. 5091c, the Commission's last avoided cost policy order. PURPA's chief avoided cost pricing objective is straight forward: efficient electric power generation. Three factors affect the pursuit of this objective: 1) avoided cost prices must be just and reasonable and in the public interest, 2) no avoided cost price shall exceed the incremental cost to the utility of alternative electric power, and 3) QF prices should not be discriminatory.

Since the interpretation of avoided costs recurs as an issue in these proceedings, the Commission's definition follows: Avoided costs are incremental costs to an electric utility of energy or capacity or both which, but for the purchase from the QF or QFs, such utility would generate itself or purchase from another source. In other words, avoided costs reflect the costs the utility would incur but for the QF. Termed the "ratepayer neutrality" standard, ratepayers should be no worse off with than without QF power.

In Order No. 5091c, the Commission continued tariffing default avoided costs, but also allowed for a negotiated option. Negotiation was allowed for several reasons. First, default prices may not reflect actual avoided costs for a variety of reasons, including actual QF size, reliability and location on the electric system. Second, a utility's tariffed avoided costs may not reflect avoidable resources. Thus, the Commission encouraged QFs to study utility plans and enter into negotiations.

The default tariff option is more structured and generic than the negotiated option. The default option features energy and capacity prices. The Commission found merit in three types of energy avoided cost options proposed by MDU and MPC: 1) historic, 2) one-year forecast and 3) long-term forecasts. Each option based avoided energy cost values on system lambda. The Commission only allowed real levelized energy prices for the long-term forecast option, option C.

The Commission found merit in requiring both real and nominally levelized capacity prices. Real levelized capacity prices, like energy option C prices, are annually adjusted for inflation, while the nominally levelized capacity price is fixed for the life of a contract. For capacity, the order analogized to the often termed "economic dispatch" basis for computing system lambda and required basing capacity prices on the highest avoidable capacity cost.

MPC was required to base avoided capacity costs on the highest cost capacity acquired by a purchase or otherwise. The Commission found MPC must use the BPA New Resource (NR) rate as the basis to compute capacity costs, until it should become necessary to change this basis. This finding was based on the tremendous uncertainty associated with MPC's resource plans. In fact, the order found MPC's capacity additions and avoided cost proposals extremely perplexing: MPC listed nearly every potential resource as an option. Also, at the time, MPC could purchase New Resource power with only six months notice, notwithstanding BPA's seven year notice requirement. In any case, MPC could voluntarily revise the BPA NR basis for capacity prices.

Development of avoided costs involves a total cost estimate and a classification of these total costs to energy and capacity. Order No. 5091c discussed the revenue requirements (RR) method to compute total avoided costs. MPC favored and currently uses the RR method to compute total avoided costs. As the order contemplated, the classification of total avoided costs is a problem, as indicated by the common nature of this issue in all three proceedings in this Docket.

The order also discussed the relation of system lambda to two other bases for avoided costs: opportunity purchases and off system sales. First, the order states purchase costs may enter into avoided cost prices to the extent a utility plans to acquire energy and/or capacity. Second, the Commission approved PP&L's proposal to include off-system opportunity sales values in avoided cost computations and extended the proposal to MPC and MDU. Order No. 5091c's intent was to base avoided costs on the greater of these three cost candidates, as evident from MPC's testimony (MPC Exh. No. 6, pp. MAS-7 and 9).

Table 1 summarizes Order No. 5091c avoided cost price computations for default energy and capacity options.

Table 1
Default Tariffs

ENERGY OPTIONS

A. Historic: A monthly ex post calculation of actual costs.

B. One-Year: An annually updated one-year cost forecast.

C. Long Run: A long-term (5 years or longer) real levelized cost forecast with on-line dates from one to ten years out into the future. This option requires an automatic annual inflation adjustment.

CAPACITY OPTIONS

Real or nominally levelized long-term (5 years or longer) forecasts with on-line dates from one to ten years out into the future. Any one of the above three energy options can be mixed with the capacity choices.

Avoided Cost Method Issues

The following reviews methods MPC has used to compute avoided costs. The Commission wishes a comparison were not needed, but MPC's proposals require such a review. Also, the method used to compute avoided costs is a key issue in these dockets. As a "road map", some changes MPC proposed involve one or more of the following: 1) changes in how total costs are classified to energy and capacity, 2) evolutionary changes through time, e.g., a compliance filing, Colstrip 4, or BGI; and 3) changed methods for different energy rate options.

MPC's 1986 Methodology

In 1986 the Commission approved the first MPC Order No. 5091c compliance filing. The method adopted in 1986 will serve to describe the pre-July 1990 method (TR p. 117). First, MPC used a different method to compute forecast energy costs for years 1986 through 1992 than for all years after 1992. Up until 1992, MPC simply made two PROMOD (a computer simulation model) runs, with the cost difference attributed to energy. After 1992, MPC based energy values on BPA purchases. Second, MPC used BPA rates for avoided capacity prices in all years. Third, MPC classified total avoided costs based on BPA power rates. Thus, there is no residual classification of costs to energy or capacity. Finally, the above discussion applies to each of energy options B and C.

MPC's July 1990 Methodology

In its July, 1990 filing MPC proposed changing the methods used to compute avoided costs from the last approved 1987 compliance tariff. MPC listed a host of reasons for the changes (MPC Exh. No. 2). Notable among the several reasons given is MPC's belief that the rate components are inconsistent with energy option B. A second reason is MPC's argument that more extensive PROMOD runs will eliminate needless complexity, improve comprehension and allow for a dynamic interaction of the real-time nature of electric power production.

MPC testified that the revised avoided cost method complies with Order No. 5091c and that no findings of fact out of orders in Docket No. 88.6.15 required changes to the Order No. 5091c methodology (TR Vol. II, p. 5). The revised method changes energy and capacity cost calculations. Using the revised method MPC would compute capacity payments on a residual basis using the most expensive marginal capacity unit on-line in a given year (TR Vol. I, pp. 116 and 138 and MPC Exh. No. 2, p. 2).

While not changing the avoided cost method used to compute the energy value (MPC Exh. No. 2, p. 2/74), MPC's revised method changes the basis of energy option payments. (Note, MPC synonymously used the term "energy value" and "system lambda" as will this order unless stated otherwise (TR Vol. II, p. 9).) With the revised method, MPC classifies energy option C avoided costs, in excess of system lambda, as capacity. At the hearing it became clear that MPC is also proposing a new basis for payments under energy option B (TR Vol. I, pp. 26 and 167). This will be explained later in this order.

MPC's BGI Methodology

In April of 1990, MPC computed for BGI a stream of avoided cost prices using a method that differs from either the 1986 or 1990 methods (MPC Exh. 6, p. RCS-3). Although MPC suggests that the method used to compute avoided cost prices for BGI is the same as that used in the July, 1990 compliance filing (PSC No. 1-007), MPC later indicated that this statement only regards the computation of total avoided costs (TR Vol. I, p. 145 and Vol. II, p. 19). Thus, the method used to classify BGI's total avoided costs differs from that in the July, 1990 compliance filing. With this change, avoided costs not classified to capacity are residually classified to energy.

III. TESTIMONY

MCC Testimony

Dr. Wilson testified on MCC's behalf and addressed the determination of rates in the BGI/MPC petition. MCC proposed at hearing to lower BGI's avoided cost prices to reflect the portion of the cost of equity associated with regulatory risk which MCC asserts MPC may not avoid (TR Vol. II, pp. 117 through 128). MCC holds there exists an unknown portion of the cost of equity that BGI may not allow MPC to avoid. To implement the proposal, MCC recommends MPC and BGI work out a deal that more accurately reflects avoided costs, which MCC asserts would be lower than MPC's proposed level (TR Vol. II, p. 150).

BGI Testimony

Mr. Sletteland, the first of two witnesses appearing on BGI's behalf, testified on the BGI/MPC contract. In addition to his testimony on the regulatory out language, Mr. Sletteland stated the Commission should approve the prices in the BGI/MPC agreement. He also rebutted MCC testimony by asserting that MCC seeks to base avoided costs on BGI's project costs instead of on the PURPA mandate.

Mr. Owen Orndorff also testified on BGI's behalf. Mr. Orndorff holds that the real issue before the Commission is whether:

> |t¬he unit specific avoided cost with BGI is, as urged by MPC in its response to data request PSC No. 1-007 ... determined using the 1990 Compliance filing methodology, which has been approved by this Commission and results in accurate avoided costs.

Prefiled Testimony of Owen Orndorff, p. 20.

In addition, Mr. Orndorff proposes a simultaneous comparison of the methods used to compute avoided costs in MPC's proposed July compliance filing with those proposed for BGI. The implication of Mr. Orndorff's testimony is that if the same method is not used, BGI's unit specific avoided costs should not be approved and regulatory out language would be appropriate.

BGI also criticized MCC's proposed 6 percent reduction in BGI's avoided cost rates; however, BGI later agreed to accept the implicit 4.5 percent reduction associated with the corrected tariffs, and agreed to the LTQF-1 effective real levelized payment stream.

Finally, BGI also addressed MCC's alternative resolution proposal. BGI suggested that such a proposal may be illegal, and added that such a proposal could eviscerate the congressional intent of PURPA if adopted nationally.

Mr. Lee Tavenner's Testimony

Mr. Tavenner testified on his own behalf in this proceeding. Mr. Tavenner's testimony raised issues which fall into three broad categories: 1) the 1988 and 1989 avoided costs; 2) 1990 avoided costs and 3) BGI's avoided costs.

The thrust of Mr. Tavenner's complaint involves what purchases can be included in avoided cost prices under energy option B. In particular, Mr. Tavenner holds his option B price should reflect BPA's NR tariff. Also, he holds that 1988 and 1989 prices should not be approved until they include BPA prices. Mr. Tavenner provided the BPA energy rates the Commission should use to retroactively adjust 1988 and 1989 avoided cost prices. For 1988 and 1989, the winter and summer prices are respectively 2.7617 and 2.666 cents per kwh.

Mr. Tavenner raised two principal issues with respect to MPC's July, 1990 compliance filing. The first involves MPC's alleged failure to reflect Order No. 5360d resource capabilities in the avoided cost rates and the second involves classifying total avoided costs. Order No. 5360d resource capabilities will be discussed later in this order.

With respect to the classification issue, Mr. Tavenner holds that, with the July, 1990 compliance filing, if power purchases are a substantial portion of the resource plan, a substantial portion of energy costs are classified as capacity. Mr. Tavenner states this classification violates Order No. 5091c on several counts. He also holds that PROMOD was programmed to not select the highest cost source of energy, and in fact does not select off system sales when the same exceeds MPC's highest estimated running costs.

Last, Mr. Tavenner addressed the BGI unit specific rate issue. Mr. Tavenner supports paying QFs a utility's full avoided costs to reflect the Commission's policy. However, the BGI prices should be recomputed to reflect a corrected resource plan, which the Commission assumes to mean a proper reflection of BPA and off system opportunity sales values.

MPC Prefiled Rebuttal Testimony

Mr. Rob Stuart summarized MPC's negotiations with BGI, indicating that initial contacts began in November of 1989. Mr. Stuart explained why MPC and BGI stated in their petition that BGI's avoided cost prices were less than the default tariff prices, when in fact the opposite is true. He explained that a mismatch occurred in the time periods used to compute the prices that were compared. Another MPC witness offered a different explanation that involved the theoretical versus practical expectations from PROMOD runs (TR Vol. II, pp. 37-39).

Mr. Stuart also explained why MPC lowered, to 85 percent, the capacity factor used to compute BGI prices. From a comparison of the original and amended Appendix A (Exh. RCS-R1), the only impact is on energy rates. In 1994, energy prices fall from 17.22 and 9.16 to 15.85 and 8.44 respectively for the winter and summer seasons. Energy prices are lower in the last year of the contract, but are not uniformly lower in each year.

Mr. Mark Stauffer's testimony served three purposes, one of which was to rebut Mr. Tavenner. Another was to discuss the changes made in the July, 1990 method of computing avoided cost prices. Mr. Stauffer also proposed amending the method of computing energy Option B for Mr. Tavenner.

Regarding Mr. Tavenner's direct testimony, Mr. Stauffer provided the following rebuttal. The only resource plan relevant to Mr. Tavenner's energy option B rate is the 1986 plan. The second rebuttal comment proposed amending the calculation of energy option B in general and Mr. Tavenner's contract in particular. The amendment has many facets, but the basis is that Mr. Tavenner's energy option B choice allows MPC to, "theoretically," avoid contracted purchases. Mr. Stauffer cites the recent Idaho Power Company (IPC) purchase as an example of a contract MPC can at least theoretically avoid. MPC explained the source of the inconsistency in Mr. Tavenner's rates (DR PSC 1-014, -015).

Mr. Stauffer also holds that there was no inconsistency in prices paid Mr. Tavenner in years 1987-1990. Mr. Stauffer rebutted Mr. Tavenner's proposed hydro capabilities and reserve margin testimony. Mr. Stauffer correctly cites Order No. 5360d as the controlling factor for not revising resource capabilities.

Last, Mr. Stauffer proposes an "improved" Order No. 5091c method to compute avoided cost prices. This aspect of Mr. Stauffer's testimony states that increasing the number of PROMOD runs, from two to three, improves the method used to compute prices.

IV. COMMISSION'S DECISION

The Commission finds that nothing in this order precludes parties from proposing revisions to the avoided cost method in Docket No. 90.8.49. That is, while these decisions resolve current issues, substantial changes to avoided cost methodology may be forthcoming in Commission Docket No. 90.8.49.

The Commission's decisions on the present proceedings are in the following order: 1) BGI/MPC petition, 2) July, 1990 Compliance filing, and 3) Mr. Tavenner's complaint.

A. BGI/MPC Petition

The Commission finds that the method MPC used to compute BGI's rates is consistent with the Order No. 5091c guide-lines. Thus, the payment stream in Mr. Stuart's Appendix A, as regards just methodological issues is in turn reasonable. While this summarizes the Commission's general finding, a few other detailed comments follow.

First, the Commission does not find merit in MPC paying BGI the 55.97 mill/kwh figure associated with MPC's July Compliance filing. Although BGI agreed to accept the real levelized payment stream associated with the 55.97 mill figure (TR Vol. II,

p. 140), such a stream does not fit with the Commission's Order No. 5091c. BGI has the right to be paid the full avoided costs MPC would otherwise incur, which correlate to the 58.53mill/kwh nominally levelized value.

Second, the Commission finds MCC's proposal to lower the avoided cost payment stream to BGI to reflect the alleged unavoidability of the regulatory risk of MPC's cost of equity is not required by the avoided cost methodology established in Order No. 5091c. MCC's proposal is a change in method that the Commission will consider in Docket No. 90.8.49. Any other proposals to change the method of computing avoided costs will be entertained in that docket.

Information will be needed to implement MCC's proposal to lower the avoided cost of equity for alleged unavoidable regulatory risk. More information will be needed on the relation between the avoidability of such costs and the inclusion of regulatory out language for any future contract. Precise estimates of unavoidable equity costs will have to exist which are separable from other aspects of the cost of equity. However, the Com mission is very interested in how this issue relates to the issue of benchmark (default tariff) avoided cost, versus competitive bid based avoided cost, which will be debated in Docket No. 90.8.49.

B. <u>July, 1990 Order No. 5091c Compliance Methodology</u>

The issue here is how to classify total avoided costs, given MPC's testimony that the total amount of avoided costs are insensitive to the approach used to compute avoided costs (<u>see</u> for example TR Vol. II, pp. 40-41). The Commission must decide upon a classification method to apply until year end 1991 for QFs less than one MW in size. The Commission does not believe this issue will be put to rest in this docket, but will be revisited in the Commission Docket No. 90.8.49.

Since the first compliance filing was approved out of Order No. 5091c, MPC has proposed two other methods to classify costs. The 1986 filing classification was simple and there was no "residual" issue. The BGI contract classified costs in a manner that made energy the residual. Three months after MPC decided upon the BGI classification method, MPC changed its favored method. The July compliance filing makes capacity the "residual."

The Commission finds that MPC must use the BGI method to recompute and classify costs for its July, 1990 avoided cost compliance filing. Some reasons for this finding follow. First, just three months prior to the July filing MPC had used a different method to compute BGI's rates. Surely, MPC knew in the April, 1990 time frame of the options it could use to classify costs which would include the July, 1986, the BGI and the July, 1990 options. Yet, MPC opted for the BGI method. Second, MPC stated no objection to using the BGI method to compute 1990 compliance avoided cost rates (TR Vol. II, pp. 41-42). Third, the issue of how best to classify total avoided costs can be revisited in Docket No. 90.8.49 for QF avoided cost and rate design purposes.

C. Mr. Tavenner's Complaint

Before deciding Mr. Tavenner's complaint, the Commission will restate why three different energy price options were tariffed. Order No. 5091c allowed QFs three energy options. The three options feature varying amounts of forecast risk the QF can choose from. However, each option was meant to reflect actual avoidable costs but for different time periods. If a QF trusted the accuracy of a utility's forecasts, the QF could select the real levelized energy option C for up to 35 years, subject to inflationary adjustments. If the same QF doubted the accuracy of the option C forecast, the QF could select a rolling one-year, option B forecast. However, Option B may also be inaccurate. To avoid forecast risk, the QF could select Option A, the actual energy costs a utility experiences.

There are a number of aspects to Mr. Tavenner's complaint the Commission will render findings on. The Commission first corrects a statement in Mr. Tavenner's testimony. Mr. Tavenner holds the Commission eliminated the escalating capacity option in Order No. 5091c. To the contrary, the Commission required real levelized capacity payments out of Order No. 5091c. The real levelized capacity option, as noted earlier, permits the QF to choose either a fixed or an unknown level of escalation for the term of the contract. In either case, with the initial real levelized energy or capacity rates escalate through time based on forecast or actual inflation, depending on the QF's preference.

Second, the Commission will state the role BPA's prices play in the development of avoided cost prices out of Order No. 5091c. As noted earlier, the PSC approved the use of BPA NR rates in Order No. 5091c. The Commission did not, however, mandate the use of BPA's NR rate or any other BPA rate in Order No. 5091c. MPC could on its own volition use BPA rate data in the development of QF rates to reflect its resource plans. In this regard, the Commission never has defined system lambda to be a BPA rate. A power purchase, however, could be based on a BPA rate. No matter how system lambda is defined MPC was required in Order No. 5091c to pay QFs the highest of system lambda, purchases and opportunity sales.

Thus, Mr. Tavenner's position that BPA rates must be used to compute his avoided cost payments is incorrect. It is incorrect historically and prospectively. The Commission will not approve of a retroactive adjustment to 1988 or 1989 rates MPC paid to Mr. Tavenner per his energy option B choice. The Commission will also not force MPC to include the BPA NR rate in this year's or any other year's energy option B, or for that matter option C, avoided cost calculation. MPC must determine whether it needs and, in turn, can avoid a BPA NR purchase, before including the BPA NR rate in the option B calculation.

Certain consistencies must exist in the resource bases of avoided cost prices. First, MPC's avoided energy costs in the first year of a real levelized energy option C must be identical to that offered under option B in the same year. After the first year the bases may diverge. That is, the energy avoided cost basis in the second year of an option C contract does not have to equal the forecast energy value for option B. Second, there is only one energy option B MPC computes each year for payments to QFs with option B contracts or for QFs that may select option B.

An example should help to explain the above. Assume there are four QFs. The first signed an energy option B contract in 1986 (B86). The second and third signed up under energy option B and C respectively in year 1990 (B90 and C90). The fourth signs up under option C in 1991 (C91). Now in 1990, the 1990 avoided cost basis for B86, B90 and C90 energy payment is identical, and the payment to B86 and B90 is equal. Then in 1991, the avoided cost basis for B86, B90 and C91 energy payments is identical, and again the payment to B86 and B90 is equal. Even though B90 and C90 signed up in the same year, the energy payments, other than the first year, may never be the same because option C is real levelized, and option B is a year by year estimate. In addition, forecast error will cause B90 and C90 to diverge over time.

With respect to Mr. Tavenner's general resource capability comments the Commission finds MPC's rebuttal correct. First, the purpose of these proceedings is to review whether certain rates have been calculated consistent with established avoided cost methodology, not to debate specific resource capabilities. A review of resource capabilities could not have been and was not the intent of this proceeding. The Commission will consider changed resource capabilities and reserve margin issues in Docket No. 90.6.39. In addition, it is not just Mr. Tavenner's energy option B but also forecast energy option B and C avoided costs that are impacted by this decision. Thus, changed resource capabilities must await the final order in Docket No. 90.6.39. However, if MPC made an error in any resource assumption that it can correct in recomputing the 1990 compliance filing, MPC should do so.

The Commission finds no merit in adopting MPC's proposed amendment to Mr. Tavenner's option B energy contract. First, the option B energy price was voluntarily selected by Mr. Tavenner. Mr. Tavenner held that because the first year of the Option B price included BPA rates, he expected it always would. Order No. 5091c did not state energy option B must be based solely on BPA NR rates. Second, the Commission believes the Idaho Power Company purchase may not practically be avoidable aside from any theoretical deferral (Stauffer Direct, p. MAS-8). If it were an avoidable purchase, merit would exist in factoring the cost into Mr. Tavenner's contract, and for that matter the revised 1990 compliance filing per Order No. 5091c.

CONCLUSIONS OF LAW

The Montana Power Company is a public utility within the meaning of Montana law, Section 69-3-101 and 69-3-601(3), MCA.

The Commission properly exercises jurisdiction over the rates, terms, and conditions for the purchase of electricity by public utilities from qualified cogenerators and small power producers. Sections 69-3-102, 69-3-103 and 69-3-601-604, MCA. Section 210, Pub. L. 97-617, 92 Stat. 3119 (1978).

The rates determined according to this Order are just and reasonable in that they were calculated consistent with Commission approved methodology and reflect MPC's avoided costs.

The Commission properly exercises jurisdiction over certain complaints against public utilities pursuant to 69-3-321, MCA.

ORDER

The unit specific avoided cost rates computed for BGI are determined just and reasonable as consistent with the meth odology contained in Commission Docket No. 84.10.64, Order No. 5091c.

The regulatory out language at issue in the joint petition should be deleted from the contract under review. The Commission determines nothing about the proposed contract between MPC and BGI save for the determinations made at paragraphs 1 and 2 of this Order section.

MPC's request that the complaint of F. Lee Tavenner be dismissed is denied.

The Complaint of F. Lee Tavenner against MPC is determined to be without merit.

MPC's objection to the Commission staff's introduction of evidence is overruled for the reasons discussed in Commission Order Nos. 5399b (MDU Docket No. 88.11.53) and 5360e (MPC Docket No. 88.6.15).

DONE AND DATED THIS 8th day of January, 1991 by a vote of 4 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

HOWARD L. ELLIS, Chairman

DANNY OBERG, Vice Chairman

JOHN B. DRISCOLL, Commissioner

WALLACE W. "WALLY" MERCER, Commissioner

ATTEST:

Ann Peck
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.