

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

**IN THE MATTER OF The Consideration
of Standards to Govern Avoided Cost
Determinations**

**DOCKET NO. RM13-02
Comments of Ridge Energy, LLC**

I. INTRODUCTION

Ridge Energy, LLC (“Ridge”) hereby respectfully submits comments on the South Dakota Public Utilities Commission’s (“Commission”) request for comments in the above-captioned docket. At the outset, it is important to understand that the Public Utility Regulatory Policies Act, 16 U.S.C. § 824-a3 (“PURPA”) is a federal law which is required to be implemented by the states, including South Dakota. 16 U.S.C. § 824a-3(f) (2006); *accord FERC v. Mississippi*, 456 U.S. 742, 751 (1982); *Independent Energy Producers Association v. California Public Utilities Commission*, 36 F.3d 848, 856 (9th Cir. 1994); *Cogeneration Coalition of America, Inc.*, 61 FERC ¶ 61,252, at 61,925-26 (1992). This directive to the states includes the requirement that the various state commissions implement PURPA consistently with the regulations adopted by the Federal Energy Regulatory Commission (“FERC”). *Exelon Wind I, LLC*, 140 FERC ¶ 61,152, at P 44 (2012)(“As a result, a state may take action under PURPA only to the extent that that action is in accordance with the Commission's regulations.”)

PURPA allows a QF the option as to how it will sell its generation to a utility. As the Court in *Exelon Wind v. Smitherman*, 2012 WL 4465607, at * 2 (W.D. Tex. 2012), stated:

FERC, acting pursuant to its mandate under PURPA, has created two vehicles by which QFs may require utilities to purchase their energy. *See* 18 C.F.R. § 292.304(d). First, QFs have the option of simply selling energy as it becomes available. *Id.* § 292.304(d) (1). Alternatively, QFs may opt to create a “legally enforceable obligation” (LEO). *Id.* § 292.304(d)(2). A LEO functions much like a bilateral contract, except the utility’s “assent” occurs by operation of law: it is an offer the utility cannot refuse.

QFs often must obtain financing to construct, operate, and build a project, thus FERC adopted regulations specifying that the choice of how a utility will offer to sell its generation to a utility was best left to the QF. The need for cost certainty by QFs in making their commitments was, as noted by the Ninth Circuit Court of Appeals in *Independent Energy Producers Association, Inc., v. California Pub. Util. Com’n*, one of the reasons that QFs are entitled to sell their generation based “at an avoided cost rate calculated at the time the contract is signed.” 36 F.3d 848, 858 (1994) (citing 18 C.F.R. § 292.304(d)(2)). If the QF commits to sell its generation to a utility pursuant to a “legally enforceable obligation” or “LEO,” the QF has the choice of selecting the length of that commitment. 18 C.F.R. § 292.304(d)(2). Or, as the *Smitherman* court put it: “Significantly, when a QF elects the LEO option—to lock-in energy sales over a period of time—it then has a further choice to make: to sell power either at rates calculated upon delivery, or based on avoided costs calculated at the time the LEO is created.” *Smitherman*, 2012 WL 4465607, at * 2.

II. STANDARDS FOR AVOIDED COST

As noted above, state commissions must implement PURPA in a manner consistent with FERC’s regulations, although they may do so by “issuing regulations, by resolving disputes on a case-by-case basis, or by taking other actions reasonably designed to give effect to [the Commission’s] rules.” *FERC v. Mississippi*, 456 U.S. 742, 751 (1982); *see also* 1983 Policy

Statement, 23 FERC ¶ 61,304, at 61,643 (1983). This necessarily includes the requirement that a state commission calculate avoided cost consistently with FERC's implementing regulations.

Avoided cost is defined in FERC's PURPA regulations as "the incremental costs to an electric utility of electric 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." 18 C.F.R. § 292.101(b)(6). As interpreted by the Ninth Circuit Court of Appeals in *Independent Energy Producers*: "[P]ublic utilities are required to purchase electric energy from QFs at a rate that is equal to the incremental cost to the utility of purchasing or generating energy elsewhere." 36 F.3d at 850.

The avoided cost to be paid to a QF must also be the "full" avoided cost:

The second group of the Commission's regulations, Subpart C regulations, 18 C.F.R. § 292.301-.308, regulate the purchase of energy by utilities from QFs as required by § 210 of PURPA. They require that utilities purchase electric energy from and sell electric energy to QFs at the Utility's full "avoided cost" rate. 18 C.F.R. § 292.304(d).

Id. at 851.

Another requirement is that the utility's avoided costs may vary over the length of a particular QF's commitment to sell to QFs, but that does not render the avoided cost calculation determined at the time the LEO was created inconsistent with PURPA's regulations:

FERC's other regulations are consistent with this understanding, and belie the parade of horrors raised by Defendants asserting that allowing firm QFs to create LEOs would be contrary to the public interest. The avoided cost system (which protects the public interest, and guarantees the just and reasonable rate requirement, by assuring utilities pay no more than their avoided cost) applies to fixed-rate LEOs just as much as to as-available energy sales (or to LEOs based on price determined at delivery). *See* 18 C.F.R. § 292.304(a)(2), (d)(2). "If purchase rates are set at the utility's avoided cost, consumers are not forced to subsidize QFs because they are paying the same amount they would have paid if the utility had generated energy itself or purchased energy elsewhere." *Indep. Energy*, 36 F.3d at 858. Nor can Defendants object that rates locked in through a LEO might, in some instances, exceed avoided costs at various points in time throughout the life of the LEO (due to price fluctuations, and errors in estimating future avoided

costs when the LEO is created). “Federal regulations provide that QFs are entitled to deliver energy to utilities at an avoided cost rate calculated at the time the contract is signed.” *Id.* “The Commission recognized that, at times, the avoided cost rate provided in the contract might be greater or less than the utility's current avoided costs but that certainty as to rate was important.” *Id.* Furthermore, FERC regulations regarding determining avoided costs have already taken into account issues such as reliability and capacity. *See* 18 C.F.R. § 292.304(e) (2). Accordingly, Congress's command that rates conform to the public interest, and be just and reasonable, has already been given effect by FERC's regulations.

Smitherman, 2012 WL 4465607, at p. 9.

Another requirement is that the utility’s full avoided cost must be based on the incremental energy avoided for the utility as a whole, not just the price the utility pays at a particular location or node such as an energy imbalance market or local marginal price or “LMP.” FERC recently considered just such an avoided cost pricing methodology adopted by the Texas commission, and found it inconsistent with PURPA:

The problem with the methodology proposed by SPS and adopted by the Texas Commission is that it is based on the price that a QF would have been paid had it sold its energy directly in the EIS Market, instead of using a methodology of calculating what the costs to the utility would have been for self-supplied, or purchased, energy “but for” the presence of the QF or QFs in the markets, as required by the Commission’s regulations.

Exelon Wind 1, LLC, 140 FERC ¶ 61,152 at P 52.

The problem with LMPs as the basis for avoided cost is that they do not reflect a utility’s avoided costs as much as they indicate current indicative prices at particular locations or nodes within a balancing authority’s control area. They are not the price that a utility would pay for energy and capacity “but for” purchases from a QF, but simply a short term indication of the price paid at a particular location for purposes of sending congestion signals to market participants. In the Commission’s recent decision in Docket No. EL11-06, *In the Matter of the Complaint by Oak Tree Energy LLC Against NorthWestern Energy for Refusing to Enter into a*

Purchase Power Agreement, Oak Tree witness J. Richard Lauckhart pointed out the numerous flaws in using LMPs to establish avoided cost. Mr. Lauckhart stated:

Now Mr. Lewis takes the Argus assessment, and he reduces that by 4 and a half dollars a megawatt hour. Based on his view the history of LNPs between sort of the Illinois point up and here closer to where we are in South Dakota in this back time period there was a 4 and a half dollar LNP difference.

Well, we know that one ... of the major purposes of the [sic] LNP approach was to send price signals, locational was to send price signals about locations. And the only reason there would be a price differential in the MISO analysis is because of congestion or losses. Mr. Lewis kept talking about wheeling charges, but they don't have wheeling charges. It's congestion and losses.

Now if there's 4 and a half dollars, that's primarily just by congestion because that seems like it must be mostly congestion because losses isn't going to be a big part of this. If it's mostly congestion and there's a 4 and a half dollar price difference here, somebody ought to look to see what's causing the congestion. Is it just like one little span of wire between here and here that if we re-conductor that, we can eliminate most of that congestion?

Mr. Lewis assumes this 4 and a half dollar price signal is not going to cause anybody to do anything differently over the next 20 years. I think that assumption is suspect, at best.

Hearing Transcript, EL11-06, at 327, line 18, through 328, line 20 (December 6, 2012).

When asked what he meant by “anybody to do anything differently over the next 20 years,” Mr. Lauckhart added:

I'm saying causing somebody at MISO, maybe the transmission planning guys at MISO saying, hey, we ought to look at solving this particular congestion problem. Let's put together a plan and next year we'll go out and build some transmission and greatly reduce or hopefully eliminate that congestion.

Id. at 328, line 24, through 329, line 4.

When asked what he thought of using LMPs as the basis for avoided cost, Mr. Lauckhart concluded by stating:

Well, if we're talking about a 20-year forecast of avoided cost. That 4 and a half dollar adjustment in my mind assumes that price signal never causes anything to happen over the 20 years. I don't think that's a good assumption.

Id. at 329, lines 9-13.

In summary, calculating an avoided cost using LMPs is not appropriate. First, the prices are reported historically, and not on a forecast basis. To forecast using LMPs, one has to assume that the congestion signals being sent by transmission planners will change over time as it becomes apparent that there is a need for new transmission upgrades in order to permit energy to flow freely to that particular node. In order to predict these changes to the transmission system, one has to determine what particular changes would be made, and this is an enormously difficult undertaking. Although each avoided cost calculation is more art than science, using LMPs as the basis for avoided cost is, in addition to being inconsistent with FERC's regulations, an exercise in rank speculation.

III. CARBON COSTS

In the *Oak Tree* decision, the Commission ultimately decided not to include carbon costs because the Commission found they were too speculative for inclusion. Amended Final Decision and Order, Finding of Fact ¶ 15, May 17, 2013. However, the current administration continues to push for controlling carbon emissions as a mechanism to combat climate change. On September 20, 2013, the United States Environmental Protection agency proposed new standards for carbon pollution for power plants. See: <http://www2.epa.gov/carbon-pollution-standards/2013-proposed-carbon-pollution-standard-new-power-plants>. The Obama Administration has made climate change a priority, and the Commission should consider carbon costs in future calculations as it is likely to have a major effect in the future on the cost of power for South Dakota utilities.

IV. RENEWABLE ENERGY CREDITS

Again, in the *Oak Tree* decision, the Commission rightly found that the renewable energy credits that are to be generated by the Oak Tree project remain with Oak Tree, and that Oak Tree is free to market those credits. Amended Final Decision and Order, Finding of Fact ¶ 28, May 17, 2013. Unless the Commission desires that a QF sell its renewable energy credits for value to the utility which buys the QF's generation in order to meet South Dakota's renewable objectives, the renewable energy credits should remain with the QF. There is no good policy basis for the Commission to reverse this decision.

V. CONCLUSION

Ridge Energy wishes to thank the Commission for this opportunity to comment. In summary, these are the requirements of PURPA with respect to avoided cost:

- A QF may choose to sell its generation either on an as available basis or pursuant to a LEO over a specified term. The QF chooses the term.
- Avoided cost must be based on the incremental cost of energy to the utility, either calculated at the time the QF's generation is delivered to the utility, or at a "locked in" rate calculated from the time the QF makes its commitment to sell its generation to a utility over the term the QF has selected.
- Avoided cost must be based on the full avoided costs of the utility, not some lesser, discounted costs.
- The fact that avoided costs may vary over the length of the term of the QF's commitment does not mean they are inconsistent with the avoided cost requirement in PURPA. FERC contemplated this result, and decided that investment in new

technologies (meaning, the need to obtain financing) required that a QF be able to “lock in” a rate over a specified term.

- Avoided cost cannot be based on specific locations within a utility’s system, but based on the utility’s full cost reflected by the costs avoided by the utility “but for” the presence of the QF that sells its generation to the utility. LMPs are too speculative to use as the basis for avoided cost, as the LMPs are historical prices that must be forecast and that forecast must necessarily include planning assumptions of transmission planners who will not be parties to the avoided cost proceeding.
- Whatever the Commission decides to do with respect to avoided costs, it must be consistent with FERC’s PURPA regulations.
- Carbon costs should be considered and included in avoided cost calculations in the future. There is every reason to suspect that carbon costs will be a major factor in future utility power prices and thus, these utilities avoided costs.
- Renewable energy credits should remain with QFs.

SUBMITTED THIS 3RD DAY OF DECEMBER, 2013

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