

## PURPA: It's not just for IOUs anymore

**T**he Public Utility Regulatory Policies Act of 1978 (PURPA) is a federal law that, among other things, requires electric utilities to purchase wholesale power from certain eligible wholesale generators. Although a portion of PURPA establishes retail rate-setting principles applicable to regulated utilities, the heart of the statute lies in its mandate that electric utilities must purchase wholesale power from qualifying facilities (QFs). This is known as the “must-purchase” obligation. The price that the electric utility shall pay the QF for power is equal to the utility’s full avoided cost for power. Note that this does not mean the utility’s average cost of power, but the “incremental” cost that the utility would incur to acquire power but for the purchase from the QF. In most cases, the utility’s incremental avoided costs will be higher than its average system costs.

There may be a misconception in our region that PURPA only applies to investor-owned electric utilities that are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). However, this is not the case. On its face, the PURPA “must-purchase” obligation applies to all “electric utilities” without limitation as to their jurisdictional status. The term “electric utility” is specifically defined in PURPA so as to include “municipalities” (although it expressly excludes federal power marketing agencies). The term “municipality” is itself defined very broadly to include any political subdivision or agency of a state that is authorized to “carry on the business of developing, transmitting, utilizing, or distributing power.” Thus, PURPA applies to consumer-owned utilities as well as investor-owned utilities.

Notwithstanding the fact that it applies to all electric utilities, the PURPA “must-purchase” obligation has historically affected only investor-owned utilities in the Pacific Northwest. This has been more for economic reasons than for legal reasons. The fact is that consumer-owned utilities in the Pacific Northwest have had access to preference power from the Bonneville Power Administration (BPA), which has kept their avoided cost for incremental power very low. By comparison, the investor-owned utilities have had to acquire their own power resources at a cost that is usually greater than BPA’s preference rate. This means that the investor-owned utilities have generally had higher avoided costs than the consumer-owned utilities. Predictably, the QFs prefer to sell their output to utilities having a higher avoided cost rate.

The market dynamics that have led QF developers to favor investor-owned utilities may be changing for three reasons. The first reason is that the investor-owned utilities have learned how to navigate the byzantine-state regulatory process so as to understate their avoided costs. In Oregon,

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for example, an investor-owned utility’s avoided cost is assumed to be “market” whenever the utility is resource sufficient. Given that the wholesale power markets are currently very low, it is no surprise that each utility in Oregon is suddenly resource sufficient (or will be in the immediate future). Further, the determination of whether a utility is resource sufficient or deficient is buried in its Integrated Resource Plan (IRP) — a document which is typically hundreds of pages long, exceedingly technical, and requires several years to change. By effectively tethering their avoided costs to market rates, and by insulating that determination from any reasonable scrutiny through the IRP process, the investor-owned utilities have drastically reduced what they must offer to pay QFs under PURPA.

The second reason why the market dynamics for QF power sales may be changing lies in BPA’s new rate-setting methodology. BPA previously offered full requirements contracts, pursuant to which it met the consumer-owned utilities’ full retail load requirements with its lowest-cost power. Beginning in 2012, however, BPA transitioned to the Tiered Rate Methodology (TRM). Under the TRM, the preference utilities’ access to BPA’s lowest (Tier 1) rate is fixed according to the utility’s load forecast for 2010 (its Contract Period High Water Mark or CHWM). Incremental increases in load above the CHWM must be served by sources other than Tier 1. This means that the consumer-owned utilities’ avoided cost for incremental power will no longer be tied to BPA’s lowest rates — and will have to be established on a case-by-case basis to reflect each utility’s above-CHWM power supply decisions.

The third reason why consumer-owned utilities may become targets for future QF power sales is geography. Consumer-owned utilities tend to be physically closer to eligible renewable and cogeneration facilities. As compared to more densely populated service territories along the I-5 corridor, many consumer-owned utilities’ rural service territories offer cheaper land, more commercially viable wind resources, better access to sunlight, more potential hydro-

electric or hydrokinetic sites, and more biomass cogeneration opportunities. While these have long been the preferred sites for locating QFs, in recent years the investor-owned utilities have gotten more aggressive about recovering interconnection, integration, transmission, and other costs associated with receiving, managing, and delivering QF power. If the historical differential in avoided costs between consumer and investor-owned utilities does indeed decline, as explained above, then QF owners will likely choose to sell their power output to the local consumer-owned utility in an effort to save on interconnection, integration, wheeling, and transmission costs.

Consumer-owned utilities need to be aware of these changing market dynamics so that they can better understand their risks, rights, and responsibilities under PURPA. At the most basic level, every consumer-owned utility that is forecasting a need to purchase above-CHWM power in the near future should include PURPA as part of their overall risk analysis. In simple terms, consumer-owned utilities should be aware of what their avoided costs for incremental power look like from the perspective of a QF developer.

Along with the potential risks, consumer-owned utilities should also know their responsibilities under PURPA. For example, even non-jurisdictional utilities in Oregon are required to file their avoided costs with the Oregon Public Utilities Commission. In addition, Congress amended PURPA in 2005 to require all non-regulated (consumer-owned) utilities with annual retail sales in excess of 500 million kilowatt-hours to formally consider implementing net metering, smart metering, interconnection, fuel sources, and fossil fuel generation efficiency standards.

Finally, consumer-owned utilities should be aware of their rights under PURPA. It is in the purchasing utility's interest, for example, to ensure that its avoided cost rates do not overstate its actual avoided costs. As part of the process of establishing its avoided costs, the purchasing utility may be entitled to take into account certain project-specific costs associated with interconnection and integration of QF power. The purchasing utility also is entitled to reasonable contractual protections such as financial security and minimum performance obligations.

To date, PURPA has largely been an issue affecting only investor-owned utilities in our region. This does not mean, however, that consumer-owned utilities are immune from PURPA's must-purchase obligation. Recent trends indicate that the avoided cost rates being offered to QFs by investor-owned utilities are falling precipitously. At the same time, the avoided cost rates offered by many consumer-owned utilities may no longer be constrained by the price of BPA's preference power. While this trend may not provide enough financial incentive to spur new QF development, it may well result in existing QF projects with expiring long-term power purchase agreements looking to consumer-owned utilities for replacement contracts. Consumer-owned utilities — particularly those that have both above-CHWM load forecasts and existing QF projects located nearby — would do well to plan accordingly. **NWPPA**

*Richard Lorenz is with Cable Huston Benedict Haagensen & Lloyd LLP, a full-service law firm located in Portland, Ore. He can be contacted at [rlorenz@cablehuston.com](mailto:rlorenz@cablehuston.com).*

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