

December 6, 2002

TO: Distributed Generation Working Group on Tariffs

**FROM: The Minnesota Project
The Institute for Local Self Reliance
The Izaak Walton League of America, Midwest Office**

RE: Comments on Base Tariff and Capacity Payment for Distributed Generation

In response to the Nov. 25th email request for comments from the Minnesota Department of Commerce (DOC), we are submitting joint comments on the calculation of a base tariff and a capacity payment for distributed generation (DG).

Base Tariff for DG

- 1. True-up for the base tariff (which is based on the utility's avoided energy costs) should have a well-defined trial period, with set criteria that would trigger a true-up.***

We generally support the proposal by the DOC to calculate avoided energy cost. However, the language needs to be firmed up with respect to the trial period and a threshold for estimated costs that would trigger a true-up. Option B continues to be our preferred method of calculating avoided energy costs. Option B comes closest to real time pricing, which we believe can best reward DG for producing electricity when utilities need it most and thus send the correct market signals.

Option B, however, lacks definition of a trial period and does not establish a threshold that would trigger a true-up should energy price forecasting be inaccurate or highly variable. A trial period a trigger for a true-up will ensure protection of DG customers, utilities and ratepayers in times of volatile fuel and electricity pricing.

We propose that the trial period last for five years, with the following criteria: If avoided energy cost forecasts are greater or less than actual energy prices by five to ten percent (calculated on an annual basis, not monthly) for two or more of the five years, a true-up should be required. During the trial period, if the tariff varies from the actual marginal energy prices (on an annual basis) by more than five percent, the utility would have to retroactively true-up.

If the utility fails to forecast accurately during the trial period, there would be several ways to structure the true-up (monthly, yearly, etc.), which we'd be willing to discuss at more length. We are also willing to negotiate on the exact terms of this proposal, but wanted to throw something out for discussion.

Capacity Payment for DG

2. ***The DG customer should always have the option to receive a capacity payment. The capacity payment may be different depending on if the utility's load demand is increasing or not. If demand is increasing, the capacity payment should be based on the utility's cost of building capacity; if the utilities demand is not increasing, it should be based on the price the utility can get in the open market for the capacity.***

Determining whether or not a utility needs capacity should be based on demand, not whether or not the utility is planning on adding capacity. In any given moment of time, a particular utility may not have plans to add capacity, but this is because the traditional model for adding capacity is to add it in large blocks, rather than incrementally. One large central station power plant, or a large contract for providing capacity may meet the utility's need for capacity for 10 years.

In the past, utilities actually overbuilt their capacity from what was necessary to meet demand, and there was a long period of time in Minnesota during the 1970s and 1980s when no capacity was needed. Had there been a way to add capacity more incrementally instead of in large units, Minnesota consumers might have benefited.

Minnesota laws, chapter 212 clearly specifies the tariff should promote DG. DG resources should not be penalized because the current method of planning fails to account for incrementally adding capacity. We believe that since demand across the state is continuing to grow, that all DG should receive a capacity payment. If the utility can sufficiently prove that demand is not increasing in their service territory, then they can offer a capacity payment as outlined below (under option b).

- a. ***The calculation for the capacity value of energy should be based on all the types of capacity that are used by the utility, not just what they call for in their current Integrated Resource Plan.***

Capacity can be added as baseload, intermediate, or peaking. A utility's planning document may not call for adding all of these types of capacity in a given time frame, but non-the-less, if demand is growing, so is the need for all types of capacity. For the reasons listed above, we believe that a DG owner should be compensated for all of the types of capacity. It is proposed that baseload capacity costs be costs of a new coal plant, intermediate is combined cycle natural gas, and peaking is a natural gas combustion turbine. To reflect each utility's actual situation, a weighted average could be taken, depending on how much capacity each utility has in baseload, intermediate and peaking.

- b. ***If a utility does not need the capacity, we support the proposal to have the utility sell the capacity to other markets that do need the capacity. We would suggest that utilities be required to buy the capacity, which they could then sell.***

The market to buy and sell capacity has many barriers to entry, not the least of which is learning the rules of the game. Utilities are already market players in the electricity market, and there should be relatively small additional costs for the utility to market DG owners' capacity. In the interests of promoting DG, we suggest that utilities that don't have rising demand, and thus no need for additional capacity, be required to sell DG owner's capacity on the open market if the DG asks them to, for an administrative fee.

- 3. It is reasonable to have the DG customer pay for an URGE test in order to receive capacity payments. However, the DG customer should not have to be held to an even higher standard than this, as appears to be suggested by the utilities' proposal.***

If the standard for determining a capacity value is to use what MAPP uses to test for capacity, then it is reasonable to make the DG owner pay for that test in order to get a capacity value. However, we are not aware that MAPP requires utilities to measure the operational capacity factor of their own plants in order to further prove the capacity value of the plant, and neither should DG owners.

- 4. Responding to the Department's proposal for dealing with length of contract, we would re-iterate our position that DG cannot be directly compared to a central station power plant, and therefore there should be no discounting for length of contract.***

We appreciate the effort of the Department to propose a method for calculating how a DG capacity payment should be discounted for a shorter length of contract than it might usually have. However, we feel that it has not been sufficiently demonstrated that a utility would be disadvantaged by a shorter DG contract than with a longer-term conventional power purchase. There are many reasons to believe that the comparison of a DG power purchase contract to a utility's contract to purchase large amounts of firm power is not accurate.

A simple one is that DG owners, especially small ones, are not providing large amounts of power relative to the utility's system. Therefore, the impact on the grid from an individual DG generator should the power suddenly not be there (ostensibly the reason for the utility wanting long-term contracts in the first place), is smaller. The same quantity of power provided by a utility long-term contract, if provided by DG, would come from multiple sources and inherently be less risky.

Again, the legislature has made it clear that the rules we propose should promote DG. In the absence of compelling evidence that shorter contracts with small power producers would disadvantage the utility, we should not put up this barrier.