

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF THE JOINT PETITION)
OF AVISTA CORPORATION AND) CASE NO. AVU-E-03-7
POTLATCH CORPORATION FOR)
APPROVAL OF A POWER PURCHASE AND)
SALE AGREEMENT) ORDER NO. 29418
_____)**

On August 25, 2003, Avista Corporation dba Avista Utilities (Avista) and Potlatch Corporation (Potlatch) filed a Joint Petition with the Idaho Public Utilities Commission (Commission) requesting an Order approving a submitted Power Purchase and Sale Agreement (Agreement) between Avista and Potlatch dated July 22, 2003. Potlatch operates a wood pulp, paperboard, tissue and wood product manufacturing facility in Lewiston, Idaho. Potlatch owns and operates four electric generators at the Lewiston plant that are capable of generating approximately 130 megawatts (MWs) of energy. The Potlatch electric generators are qualifying facilities (QFs) pursuant to the Public Utilities Regulatory Policies Act of 1978 (PURPA). Direct testimony of Avista supporting the Purchase and Sale Agreement was filed with the Commission on September 26, 2003. Also filed with the Commission on October 10, 2003 is a related Interconnection Agreement dated September 22, 2003.

The Commission in this Order approves the submitted Avista/Potlatch Power Purchase and Sale Agreement dated July 22, 2003. In doing so we find the contract terms, pricing, jurisdictional allocation and proposed recovery method to be reasonable and acceptable. The Commission in this Order approves a recovery method and authorizes the booking of Avista's power purchase costs in the Company's PCA deferral account. This Order has no immediate rate effect and does not change the tariff rates for other customers. Recovery of Potlatch power purchase costs by the Company will require a rate case or PCA filing.

Agreement

The submitted Power Purchase and Sale Agreement is for a ten-year term beginning July 1, 2003 and ending June 30, 2013. The Agreement is conditioned upon approval by the Commission of 1) a direct assignment to Avista's Idaho operations of all power purchase costs paid by Avista to Potlatch under the Purchase and Sale Agreement and 2) deferral and recovery of 100% of all power purchase costs paid by Avista to Potlatch under the Agreement to Avista's

Idaho Power Cost Adjustment (PCA) mechanism (Schedule 66) or otherwise recovered by Avista through base rates.

As recited in the Joint Petition of the parties, Avista will be the sole purchaser of Potlatch's generation and said purchase is intended to satisfy Avista's obligations under PURPA to purchase power from the qualifying facilities at the Lewiston plant. Avista will pay Potlatch \$42.92 per MWh up to a maximum base generation amount of 543,120 MWh (544,608 during a leap year) generated by Potlatch during each July 1 through June 30 period (Operating Year) of the Agreement. This amount is equivalent to 62 average megawatts (aMW) and is referred to in the Agreement as the "Base Generation Amount." Amounts generated by Potlatch in excess of the maximum Base Generation Amount each Operating Year ("Excess Generation Amount") will either be purchased by Avista at 85% of the applicable Mid-Columbia Firm Index Price, with a price cap of \$55 per MWh, or used by Potlatch to reduce its load requirements from Avista. The purchase of Potlatch's Excess Generation Amounts by Avista is limited to 43,800 MWh (5 aMW) each Operating Year. Excess Generation Amounts above this level would be used by Potlatch to serve its load requirements.

Additionally, it is noted that Potlatch has the capacity to generate additional amounts ("Incremental Generation Amounts") under certain circumstances. The Purchase and Sale Agreement provides for the purchase by Avista of Incremental Generation Amounts when it is mutually beneficial to both parties, under the terms and conditions specified in the Agreement.

As reflected in the Agreement, Avista will serve Potlatch's load requirements at Potlatch's Lewiston plant under its Extra Large General Service Schedule 25 rates, including the present Power Cost Adjustment (PCA) surcharge and all applicable rate adjustments, unless the Commission issues an Order in the future authorizing different billing rates.

Avista and Potlatch request that the Commission issue an Order approving the Purchase and Sale Agreement as a settlement of all known existing disputes between the parties, including without limitation, Case No. AVU-E-01-5 (In the matter of the Petition of Potlatch Corporation for an Order determining the terms and conditions of Potlatch's purchase of electricity from Avista Utilities) and Case No. AVU-E-02-8 (a Potlatch complaint alleging that Avista was refusing to purchase the cogeneration of Potlatch's PURPA qualifying facilities at its Lewiston plant).

On October 23, 2003, the Commission issued Notices of Joint Petition and Modified Procedure in Case No. AVU-E-03-7. The deadline for filing written comments was November 14, 2003. The reply deadline was November 28, 2003. Commission Staff was the only party to file comments. No reply comments were filed.

Staff Comments

Staff recommends that the Commission approve the submitted Power Purchase and Sale Agreement between Avista and Potlatch. Staff comments can be summarized as follows:

Proposed Price for Potlatch Generation

Staff notes that Potlatch's generators have been certified by the Federal Energy Regulatory Commission (FERC) as PURPA "Qualifying Facilities." As such, Avista has an obligation under PURPA to purchase power offered for sale at avoided cost rates established by the Commission. The established method for determining avoided cost rates for projects larger than 10 megawatts is an Integrated Resource Plan (IRP)-based methodology. The avoided cost methodology is described in Order No. 26576 and its accompanying Settlement Stipulation. The rate computed for Potlatch is the first under the IRP-based methodology.

A. Determination of the Contract Rate for Base Generation

Avista performed an analysis using the AURORA computer model to determine the value of Potlatch's generation. Using the same computer model, Staff reviewed the analysis and computations done by Avista, verified the input data and the assumptions and confirmed the rate offered to Potlatch. Staff believes Avista has correctly followed the methodology for computing an avoided cost rate as described in Order No. 26576. The rate for Base Generation Amounts of \$42.92 per MWh is the 10-year levelized avoided cost rate from Avista's 2002 IRP. The rate represents an estimate of future market prices that fully reflects the fixed costs of new generation.

Another method used by Staff to verify the value established for Potlatch generation was to compare the purchase price to published avoided cost rates for projects 10 MW and smaller. The non-fueled published avoided cost rate for a 10-year contract length with a 2003 online date is \$44.43 per MWh. These rates are based on the cost of generating energy using a gas-fired combined cycle combustion turbine (CCCT). The small difference in these two prices, Staff contends, can be justified based on the different operating characteristics of Potlatch generation and a CCCT. The 10-year levelized price approved by the Commission and paid by

Avista for Potlatch generation in the 1992 special contract was \$41.50 per MWh. The annual cost for Avista to purchase Potlatch generation is only \$420,000 more than it was under the old contract and will remain in effect over the entire life of the new Agreement.

Staff concludes that the contract rate for Base Generation was appropriately derived and reasonably supported and recommends approval.

B. Contract Rates for Excess and Incremental Generation Amounts

Under the Agreement, Excess Generation (i.e., amounts generated by Potlatch in excess of the Base Generation Amount) will either be purchased by Avista at 85% of the applicable Mid-Columbia (Mid-C) firm index price, with a price cap of \$55 per MWh, or used by Potlatch to reduce its load requirements from Avista. The purchase of Potlatch's Excess Generation Amounts by Avista is limited to 5 aMW (43,800 MWh) each operating year. Staff believes that a purchase price equal to 85% of the Mid-C index price is reasonable. In addition, Staff contends that the rate is consistent with comparable rates paid by other utilities. The price is the same as the price paid by Idaho Power Company for the equivalent of excess energy in some of its PURPA contracts and is also equal to Idaho Power's non-firm energy rate under its electric Schedule 86.

Staff also believes it is reasonable to cap the price paid for Excess Generation amounts at \$55 per MWh. A price cap of \$55 will insure that Avista is not forced to pay excessive amounts, yet it will provide the Company an opportunity to purchase small amounts of energy at below market prices when supplies are limited.

Incremental Generation is energy produced by Potlatch that exceeds the Base Generation Amounts and the Excess Generation Amounts. The rates for Incremental Generation are either: a) for prescheduled generation, 85% of market price from a unit contingent sale that Avista is able to make with a third party, or b) on a real-time basis at 80% of market price for the hour. Staff believes that these rates are reasonable for Incremental Generation. As the Agreement is structured, both parties will benefit from the sale and purchase of Incremental Generation. Potlatch will be able to receive additional benefit from its extra generation during periods when market prices are high, while Avista will be able to benefit by purchasing from Potlatch at below market prices.

Staff concludes that the methodology for calculation of contract rates for Excess and Incremental Generation Amounts is reasonable and recommends approval.

Service Pricing

Staff notes that the 1992 special contract price for Avista to serve Potlatch was essentially based on electric prices in the market place. The price of all but the 25 MW of interruptible load also included floor and ceiling prices. The average cost for non-interruptible service under the old contract was approximately \$42.50 per MWh in 2001.

Under the proposed Agreement, Avista will provide service to Potlatch under the terms and conditions of the Company's existing Extra Large General Service Schedule 25. This schedule requires Potlatch to pay an average base rate of \$31.71 per MWh, generating approximately \$27.7 million per year in base revenues. Potlatch will also be subject to the Tax Adjustment Schedule 58, the Temporary Rate Adjustment Schedule 65, the Power Cost Adjustment Schedule 66 and the Energy Efficiency Rider Adjustment Schedule 91. When the rate from non-tax Schedules 65, 66 and 91 are added to the base rate, the 2003 price paid by Potlatch for service averages \$38.65 per MWh. Although Potlatch's 100 MW of load exceeds the Schedule 25 limit of approximately 25 MW, Schedule 25A which is part of Schedule 25 states:

Customers whose demand from all such meters exceeds 25,000 KVA (25 MW) may be served under special contract wherein the rates, terms and conditions of service are specified and approved by the IPUC. If customer requires service during either the contract negotiation or resolution period, service will be supplied under this rate schedule. . . .

Potlatch, Staff notes, is by far Avista's largest single customer and electric Schedule 25 has the largest load requirement currently approved by the Commission for Avista. Absent an analysis to specifically identify Potlatch service costs, Staff contends that Schedule 25 is the most appropriate proxy to reflect Potlatch embedded cost of service. Given that current Schedule 25 rates are based on the embedded cost to serve a group of industrial customers that are much smaller than Potlatch, Staff speculates that it is likely that specific embedded costs to serve Potlatch could be lower than those used to set Schedule 25 rates. The Agreement allows either party in the context of a future proceeding to argue that the cost to serve Potlatch justifies rates that are either higher or lower than those found in Schedule 25.

Staff concludes that without a cost of service study the Agreement's proposed use of Schedule 25 as a proxy for pricing Potlatch's load is reasonable and recommends approval.

Jurisdictional Allocation

A. Background

The methodology approved by the Commission to historically allocate cost between Avista's various jurisdictions includes an allocation of all generation costs based on the jurisdictional weighting of demand and energy (67% Washington; 33% Idaho). Revenue, on the other hand, has always been directly assigned to the jurisdiction where the customer resides.

Prior to 1992, Avista paid nothing for Potlatch generation and received revenue from Potlatch based upon the net load served after Potlatch used its generation to partially offset its load. Revenues from this service arrangement remained in the Idaho jurisdiction and generation costs associated with serving the net load were allocated among the Idaho and Washington jurisdictions.

Under the 1992 special contract, Avista purchased all Potlatch generation at a pre-established price and received revenue from Potlatch based on its total load. The effect of this service arrangement under traditional jurisdictional allocation methodology was simply an increase in generation costs allocated to other jurisdictions. This is due to a traditional allocation methodology that adds generation cost to the system on the margin but allocates increased system generation costs to Idaho on the average (i.e., treating Potlatch load that was previously self-generated as having an entitlement to embedded cost resources). Allocation of all revenues on a situs basis compounded the problem. To counteract this effect, the 1992 contract approval included allocation of 60 MW of Potlatch revenues as well as purchase power costs of 60 megawatts of Potlatch generation on a jurisdictional basis. This adjustment was a compromise that balanced costs allocated to the various jurisdictions with offsetting revenues and worked fairly well because revenues from 60 megawatts of Potlatch load were fairly close to the costs of purchasing 60 megawatts of Potlatch generation.

B. Agreement – New Potlatch Allocation Methodology

Under the new Agreement, the cost of purchasing 60 megawatts of Potlatch generation is significantly higher than the revenue generated from serving 60 megawatts of Potlatch load. Consequently, the Company is proposing a different jurisdictional allocation method. Avista proposes to directly assign all revenues and costs associated with the additional 60 megawatts of Potlatch load and generation to Idaho. This allocation methodology places the net cost of buying from Potlatch and selling to Potlatch on the Idaho jurisdiction. Under the

net cost of buying from Potlatch and selling to Potlatch on the Idaho jurisdiction. Under the Company's allocation proposal, all of the Company's other jurisdictions will be held harmless.

Although no other generation costs are jurisdictionally allocated in this fashion, the Company believes it is appropriate in this case because the Agreement provides the opportunity for additional benefits to Idaho customers and Idaho is the primary beneficiary of "secondary" benefits. Avista states also that it does not believe the Washington Utilities and Transportation Commission (WUTC) would accept the ratemaking consequences of the Agreement using traditional allocation methodology. Nor, the Company states, does it believe that Avista shareholders should bear the additional costs deemed unacceptable by the WUTC. The Company believes the Agreement is "an Idaho solution to an Idaho problem."

Staff notes that the Company has conditioned the appropriateness of the proposed purchase/sale rates on the Commission's approval of the Company-proposed allocation method. The fact is, Staff observes, the net cost of the Agreement increases under the proposed rates because expenses exceed revenues. For Avista to be made whole under the jurisdictional allocation previously approved for the old contract, the Company must collect a large portion of the excess costs from Washington customers. From a practical standpoint, someone must pay the difference between serving Potlatch at embedded cost and purchasing Potlatch generation at marginal cost. Staff recognizes that Potlatch is an Idaho customer providing employment and taxes in Idaho. If rates are appropriately established and if benefits accrue primarily to Idaho, Staff believes it is also reasonable to recover the costs from Idaho customers. Staff supports and recommends approval of the Company-proposed method of cost allocation.

Cost Recovery and Revenue Impact

For the purposes of this case, Staff evaluated Idaho revenue impact by comparing net revenues/costs included in base rates under the 1992 contract to revenues/costs that will be included in rates under the new Agreement. Until the new jurisdictional allocation methodology and revenues/costs of the new Agreement are included in base rates as part of a general rate case, the Company proposes to account for the changes through the Company's Idaho PCA. The comparison also reflects that Potlatch is subject to the PCA under the new Agreement but was not subject to the PCA under the old contract.

The simplest way to evaluate the impact of the new Agreement, Staff contends, is to compare the net cost of the two contracts on a system basis. The old contract had annual system

expenses of \$28.8 million and annual system revenues of \$26.2 million for a net annual cost of \$2.6 million. The new Agreement has annual system expenses of \$31.25 million and annual revenues of \$27.7 million for a net system cost of \$3.6 million. Therefore, the new Agreement increases annual net costs by approximately \$1 million on a system basis.

However, the proposed change in the jurisdictional allocation, Staff notes, shifts most of the costs to the Idaho jurisdiction. Under the jurisdictional allocation methodology approved with the old contract, the net cost allocated annually to Idaho is actually a benefit of \$296,000. Under the allocation methodology proposed with the new Agreement, Idaho costs increase by \$4.1 million for the term of the Agreement, from a \$296,000 allocated net benefit to a \$3.8 million directly assigned net cost. A \$4.1 million increase in Idaho's revenue requirement represents the equivalent of a 2.3% overall rate increase. Until power purchase costs are included in base rates, the Company proposes to pass 100% of this annual expense increase through the Idaho PCA. Staff agrees with the recovery method proposed. Staff notes that Potlatch will contribute approximately \$5.3 million during the current year as a Schedule 25 customer subject to the PCA. The resultant net effect of the new Agreement during the 2003 PCA period is a \$1.2 million reduction in deferred costs borne by other Idaho customers.

The above analysis of revenue impact, however, is valid only under existing rates and continued service to Potlatch under Schedule 25. Staff notes that there is a possibility that the net cost of the Agreement could increase in the future if rates applied to serve Potlatch are reduced. Moreover, there will be no offsetting revenue through the PCA from Potlatch under normal water and power supply conditions to offset the effect of higher base rates. In fact, during high water conditions, Potlatch will receive some of the PCA credit that would otherwise go to other Idaho customers. However, because the rate paid to Potlatch for generation is fixed, Staff believes that it is likely that the cost differential between the cost to serve Potlatch and the cost to buy its generation will ultimately decline.

Commission Findings

The Commission has reviewed and considered the filings of record in Case No. AVU-E-03-7, including the underlying Agreement, the supporting filings of Avista and the comments and recommendations of Commission Staff. We find that the established record in this case presents an adequate basis for decision. We therefore continue to find it reasonable to process this case pursuant to Modified Procedure. Reference IDAPA 31.01.01.204.

Power Purchases (Power Deliveries to Avista)

The submitted Agreement represents that Potlatch's electric generators at its Lewiston plant are PURPA qualifying facilities. Section 210 of PURPA requires that electric utilities offer to purchase power produced by co-generation or small power producers that obtain qualifying facility (QF) status under Section 201. Under the implementing rules and regulations of the Federal Energy Regulatory Commission (FERC), the rate a QF is to receive for the sale of its power is generally referred to as the "avoided cost" rate, the incremental cost to an electric utility of electric energy or capacity or both which, but for the purchase from the QF, such utility would generate itself or purchase from another source. 18 C.F.R. § 292.101(b)(6).

The Commission finds that the \$42.92/MWh levelized purchase price for the Potlatch "base generation amount" (62 aMW) is a reasonable approximation of Avista's avoided cost and was correctly calculated under the Commission approved IRP-based avoided cost methodology. Reference Order No. 26576. We further find the 10-year contract term beginning July 1, 2003 to be reasonable. Locking in the purchase rate for that term, we find, provides benefit to the Company, its Idaho customers and Potlatch.

We find the proposed market pricing method of Excess Generation amounts to be reasonable and consistent with comparable rates paid by other electric utilities. Also reasonable are the related 5 aMW operating year limit on Excess Generation and the \$55 per MWh price cap. The third component of the Purchase Agreement is Incremental Generation. This generation is also market-based and is priced in a manner that we find reasonable. With market-based pricing, we find that the potential purchase of both Excess and Incremental Generation will provide benefit to the Company and its Idaho customers.

Power Sales (Power Deliveries to Potlatch)

The Agreement provides that Avista will provide electric service to Potlatch under the terms and conditions of the Company's existing extra large general service Schedule 25 tariff. Schedule 25 is a default rate for a customer as large as Potlatch. The Company's tariffs envision that a customer whose demand exceeds 25 MW will be served under a special contract. The Agreement allows either party in the context of a future proceeding to argue that Potlatch's service should be priced at rates other than Schedule 25 rates. Agreement § 5(b). Avista has informed the Commission of its intent to file a general rate case in early 2004. Absent further analysis and study Staff contends that Schedule 25 is the most appropriate proxy to reflect

Potlatch's embedded cost of service. Until the service rates for Potlatch are otherwise determined, the Commission finds that it is reasonable to serve Potlatch under Schedule 25. As a Schedule 25 tariff customer, Potlatch is subject to all the same rate adjustments applicable to other Schedule 25 customers.

Jurisdictional Allocation/Cost Recovery

The jurisdictional allocation method proposed by the Company is a departure from historical allocation. What is proposed is the allocation of 100% of Potlatch power purchase costs to Idaho. Without changing the allocation methodology, power purchase costs would be treated as generation and based on the jurisdictional weighting of demand and energy shared between Washington (67%) and Idaho (33%).

Avista and its Idaho customers have long benefited from Potlatch's self-generation capability. Prior to 1992 and from January 1, 2002 through June 30, 2003, Potlatch used its generation to reduce its load requirement while purchasing the remainder from Avista. From 1992 to 2002 Idaho received a net benefit from the Potlatch contract.

Avista contends that its proposed allocation of Potlatch power purchase costs is appropriate because Idaho realizes all the benefit of Potlatch's 100 MW of load and Schedule 25 revenue. Additional secondary benefits cited by the Company as accruing to Idaho and its citizens from Potlatch's continued operation in Lewiston are the benefits from continued employment, a bolstered tax base and economic spin-off benefits for other businesses.

As further justification for the proposed treatment of power purchase costs, the Company notes that the Washington Utilities and Transportation Commission (WUTC) takes a much different view of PURPA purchases than the Idaho Commission. Avista contends that the Agreement eliminates potential inter-jurisdictional disputes. The submitted Agreement, the Company contends, is an Idaho solution to an Idaho problem. While we appreciate the Company's perspective, we believe it is fair to recognize also that a utility operating in multiple jurisdictions has voluntarily assumed regulatory challenges and the related risk of disparate treatment.

Until such time as the purchase contract is reflected in base rates, the Company proposes to defer 100% of the power purchase costs for recovery in its Idaho PCA. We note that the generators owned by Potlatch are PURPA qualifying facilities. The purchase by Avista is obligatory and mandated by federal law and FERC regulations, i.e., 18 C.F.R. § 292.303. We

have always treated purchases from PURPA QFs as non-discretionary and have authorized recovery of contract costs. The \$42.92 per megawatt hour purchase price set forth in the Agreement for 62 aMW of annual base generation we find is just and reasonable and a good approximation of the Company's avoided cost. 18 C.F.R. § 292.304. The additional excess and incremental energy offered by Potlatch we find are also PURPA purchases. Potlatch is a unique customer of Avista with long and strong economic ties to Idaho. As Staff notes, from a practical standpoint, someone must pay the difference between serving Potlatch at embedded cost and purchasing Potlatch generation at marginal cost. While not choosing to speculate what the Washington Commission would do if presented with this Agreement, we find the Company's allocation proposal on the facts presented to be one of fairness and equity. As the benefits and revenue of Potlatch accrue to Idaho, so too, we find, should the related costs. Accordingly, we find it reasonable to approve the proposed allocation and method of power purchase cost recovery. In approving the requested recovery method, we authorize the booking of Avista's power purchase costs in the Company's PCA deferral account. Recovery of Potlatch power purchase costs by the Company will require a rate case or PCA filing.

Settlement of All Known Existing Disputes

Part of the mutual consideration recited in the Joint Petition is the settlement of all known existing disputes between the parties before the Idaho Commission and Idaho Courts. Joint Petition ¶ 11(b). Specifically mentioned in the Agreement are Potlatch's complaint in Idaho U.S. District Court, Case No. CV02-543-C-EJL alleging that Avista violated the terms of the 1992 Avista/Potlatch Agreement and Potlatch's complaint in Commission Case No. AVU-E-02-8 alleging that Avista had refused to purchase the co-generation output of the Lewiston plant. Agreement § 31. The Commission acknowledges that the Agreement by its terms intends to put an end to all existing litigation between the parties. We find that in addition to the cases cited, the Agreement also finally concludes Commission Case No. AVU-E-01-5, a Potlatch Petition regarding the purchase of power from Avista.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over Avista Corporation dba Avista Utilities, an electric utility, pursuant to the authority granted the Commission in Idaho Code, Title 61 and the Public Utility Regulatory Policies Act of 1978 (PURPA).

The Commission has authority under PURPA and the implementing regulations of the Federal Energy Regulatory Commission (FERC) to set avoided costs, to order electric utilities to enter into fixed term obligations for the purchase of energy from qualified facilities, and to implement FERC rules.

ORDER

In consideration of the foregoing and as more particularly described above, IT IS HEREBY ORDERED and the Commission does hereby approve the Power Purchase and Sale Agreement (Agreement) between Avista and Potlatch dated July 22, 2003.

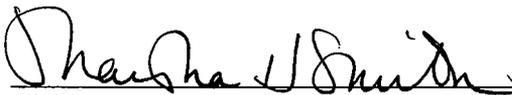
IT IS FURTHER ORDERED and the Commission hereby authorizes the booking of all power purchase costs paid by Avista to Potlatch under the Agreement in the Company's Power Cost Adjustment (PCA) deferral account. PCA recovery of Potlatch power purchase costs is authorized until such costs are otherwise included in the Company's base rates.

THIS IS A FINAL ORDER. Any person interested in this Order may petition for reconsideration within twenty-one (21) days of the service date of this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 15th
day of January 2004.



PAUL KJELLANDER, PRESIDENT

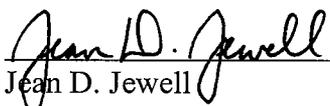


MARSHA H. SMITH, COMMISSIONER



DENNIS S. HANSEN, COMMISSIONER

ATTEST:



Jean D. Jewell
Commission Secretary

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