Idaho Power Company

Report to IPUC on Replacing the Garnet Power Purchase Agreement (PPA)

Alternatives and Recommendations to Replace the Garnet PPA

(Redacted Version)

Chapter
1

Executive Summary

Alternatives and Recommendations to Replace the Garnet PPA

On August 30, 2002, in order No. 29085 Idaho Power was directed by the Idaho Public Utilities Commission (IPUC) to prepare a report outlining alternatives for replacing the Garnet PPA if Garnet Energy LLC (Garnet) was unable to secure financing for the generating facility that would support the PPA ("the Garnet Project").

Garnet has notified Idaho Power that without material changes to the PPA it will not be possible to secure financing for the Garnet Project. In a letter dated October 24, 2002, Garnet formally proposed three options under which Idaho Power could utilize the Garnet Project site and/or equipment to provide a cost effective resource to Idaho Power. A copy of Garnet's October 24th letter containing the three proposals is included with this Report as Attachment 2. Idaho Power has preliminarily evaluated the three proposals presented in Garnet's letter and compared them to alternative resource opportunities. Since the RFP which led to the Garnet PPA was issued, a number of changes have occurred in the wholesale energy markets in the western United States. As a result of these changes Idaho Power is now optimistic that it will be able to replace the seasonal purchases specified in the Garnet PPA with a combination of resources including but not limited to, seasonal firm purchase contracts and exchange contracts in the wholesale market that will allow the Company to obtain the capacity and energy that previously would have been supplied under the Garnet PPA at prices that are equal to or less that the cost of the Garnet PPA. As a result, Idaho Power has initially concluded that there may be less expensive alternatives to the changes to the PPA described in Option 2 in Garnet's October 24 letter. The other two proposals described in the October 24 letter will continue to be analyzed in conjunction with the alternatives described below.

Idaho Power has investigated a number of potential alternatives to replace the Garnet PPA. The alternatives investigated include acquiring firm transmission rights and firm wholesale purchases, energy exchanges, adding or acquiring the output of generation resources located within the Company's control area, and integration of demand-side measures where cost effective.

The Aurora Electric Market Model was used to conduct the cost analyses. Projected costs were calculated for the base case, which included implementation of the least cost resource plan as identified in the 2002 Integrated Resource Plan (IRP) without the Garnet PPA. Projected costs were calculated for another case, which included the least cost resource plan with the Garnet PPA. Potential alternatives were then added to the base case without the Garnet PPA and projected costs were calculated. By comparing the base case without the Garnet PPA to the base case with various alternatives, the cost of each alternative was identified. The lowest cost alternatives were then aggregated to approximate the capacity provided by the Garnet PPA and analyzed as a group. The resulting costs were compared to the cost of the Garnet PPA.

Given the current forward market prices and the projected market-clearing prices calculated by the Aurora model, firm intermediate term wholesale purchase contracts and exchanges are Idaho Power's lowest cost options at this time. Given the projected market-clearing prices for electricity, building generation resources is not the least cost option in today's market environment. However, a solution based on firm wholesale purchases and exchanges, while perhaps the lowest cost alternative at this time, is not equivalent to having a dispatchable generation resource located inside Idaho Power's control area.

Although the Company believes it has the opportunity to enter into favorable firm wholesale purchase contracts for limited amounts of additional energy today, one should not conclude that additional internal generation will not be required to meet the growing demands within Idaho Power's service territory. The need for additional internal generation or construction of new transmission lines is inevitable. There are risks associated with building new transmission and relying on a robust wholesale market to supply the future needs of Idaho Power's system. However, if the firm exchange and wholesale purchase agreements identified in this report can be consummated at current price levels, then the commitment to construct new facilities can reasonably be deferred for a period of time. It should also be noted that notwithstanding the acquisition of the additional resources outlined in this report, it will continue to be necessary for Idaho Power to rely on purchases from the Pacific Northwest as reserves for emergency outages.

In the near-term, Idaho Power Company will attempt to acquire available firm transmission rights and move expeditiously to negotiate the identified firm exchange and wholesale power purchase agreements at current price levels. If firm exchanges and wholesale purchases can be secured at the prices used in this analysis, this alternative will result in a cost savings relative to the Garnet PPA over the 7-year planning period (2005-2011). Idaho Power will continue to analyze Garnet's proposals one and three, as well as other internal, generation-based strategies. If firm energy exchanges and wholesale purchases cannot be secured at favorable

prices in the near-term, then Idaho Power will need to immediately pursue acquisition/development of additional internal generation.

Costs for each option under consideration are summarized in **Attachment 1**

Chapter
2

Background

Resource Needs Leading to the Garnet PPA

2000 Integrated Resource Plan

The 2000 Integrated Resource Plan's Least-Cost Plan revealed the following:

> Beginning in 2004, transmission restrictions will cap the Company's ability to satisfy monthly capacity deficiencies with purchases from the Northwest. Therefore, the acquisition of generation resources, either by construction of a simple-cycle combustion turbine by Idaho Power, or by means of a power purchase contract that provides Idaho Power with the same operational flexibility that an Idaho Power owned simple-cycle combustion turbine would have, has been determined to be Idaho Power's optimal strategy for satisfying load requirements during the next ten years.

The 2000 Integrated Resource Plan's Near-Term Action Plan stated:

> Idaho Power Company would initiate a request for proposals (RFP) to establish the cost of acquiring dispatchable energy and capacity beginning in 2004.

Request for Proposals

On August 4, 2000, Idaho Power issued a request for proposals to satisfy monthly capacity deficits identified in the 2000 Integrated Resource Plan. Included in the evaluation of proposals was an Idaho Power Company owned and operated simple-cycle combustion turbine. In the end, a power purchase contract was selected as the preferred option to satisfy projected deficits. The selected contract was with Ida-West Energy for purchase of energy and capacity from the 273 MW Garnet facility proposed to be built in Middleton. The contract output is identified in the table shown on the following page.

Garnet Contract Capacity (MW)

	2004	2005	2006	2007	2008	2009
June	250	250	250	250	250	250
July	250	250	250	250	250	250
August	50	100	150	200	250	250
December	50	100	150	200	250	250

2002 Integrated Resource Plan

The 2002 Integrated Resource Plan assumed that the Garnet project would be completed and that Idaho Power Company would receive energy and capacity under the terms and conditions of the Garnet PPA. In addition to the Garnet PPA, the 2002 Least-Cost Resource Plan outlined the following items (identified as "Strategy 4" in the 2002 IRP) to meet future resource needs:

1) Seasonal firm market purchases of 100 aMW in the months of June, July, November, and December throughout the planning period; and

2) Integration of demand-side measures, when economically feasible, to address short duration peaks of the system load; and

3) Solicitation of proposals and initiation of siting and permitting for approximately 100 MW of peaking resource to be available beginning in 2005; and

4) Upgrade of the Brownlee to Oxbow transmission line by 2005. The upgrade will add a new 10-mile, 230 kV transmission line between Brownlee and Oxbow that will increase import capability from the Pacific Northwest; and lastly

5) Upgrade Shoshone Falls hydro plant in 2007.

With the exception of the Garnet PPA, the Garnet alternatives analysis in this report assumes that the above items are implemented as outlined in the 2002 IRP. Demand-side measures are discussed in this report, but estimated values for those measures are not used to defer or eliminate future resources.

Chapter
3

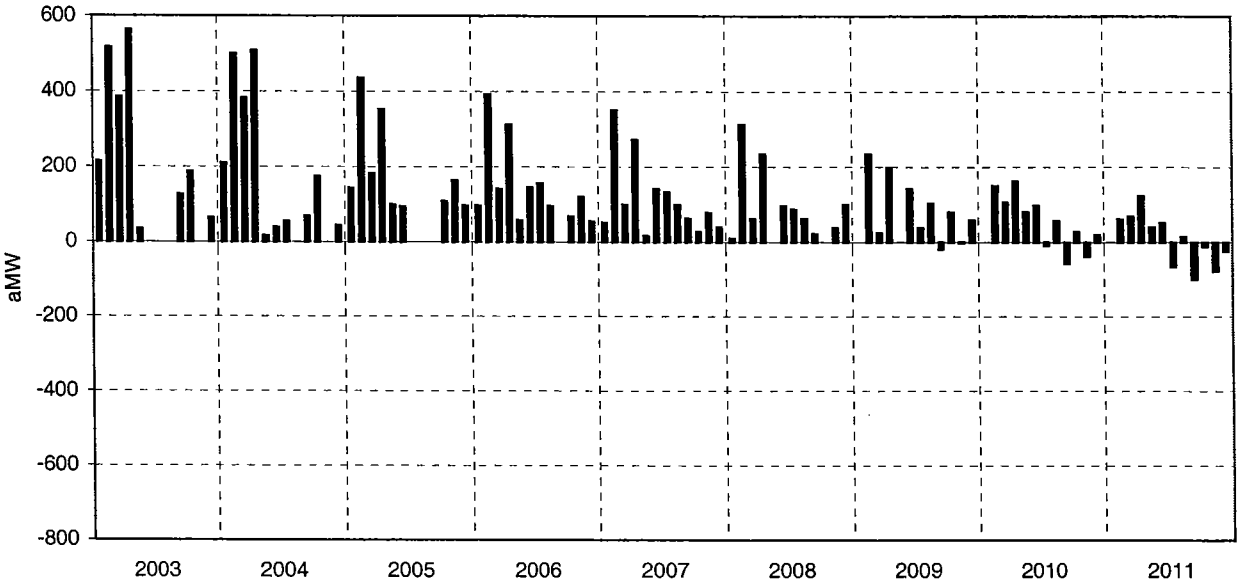
Garnet Removed

Needs Quantified

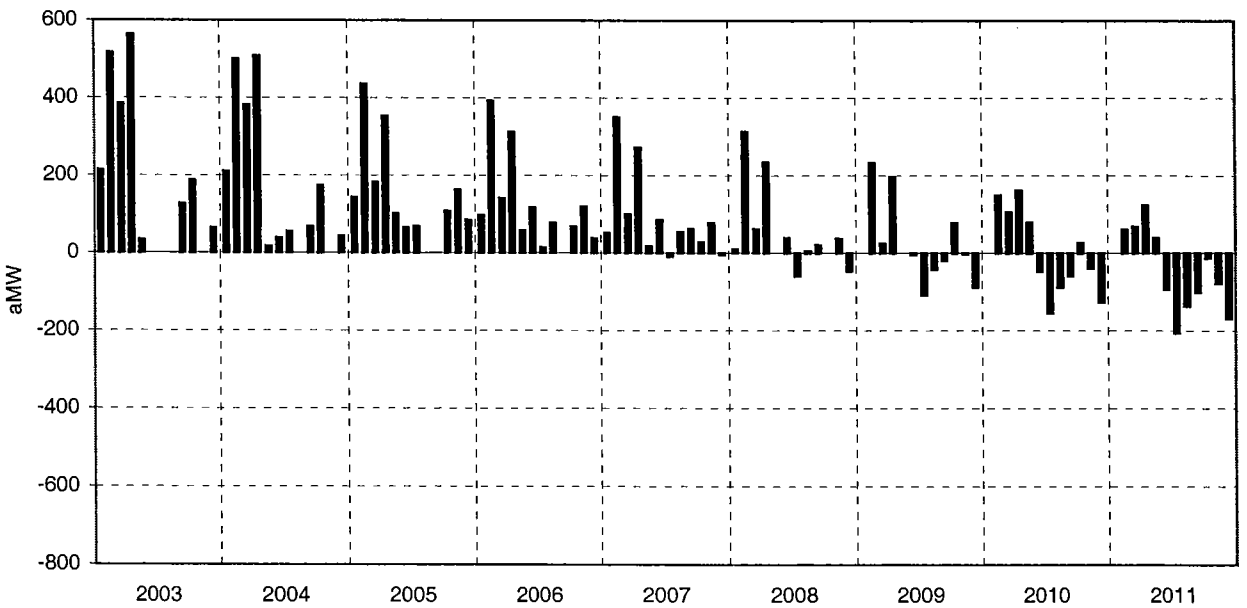
Resource Needs With and Without the Garnet PPA

The Garnet PPA was designed to provide Idaho Power with firm capacity and energy within its service territory during June, July, August, and December with the ability to acquire additional energy and capacity during non-contract periods beginning in June 2005. The charts on the following pages show energy and peak hour capacity surpluses and deficiencies with and without the Garnet PPA for the period 2003 through 2011. Also shown are transmission deficits from the Pacific Northwest (assuming all deficits are imported from the Pacific Northwest) with and without the Garnet PPA. All charts assume implementation of the least-cost resource plan (Strategy 4) outlined in the 2002 Integrated Resource Plan.

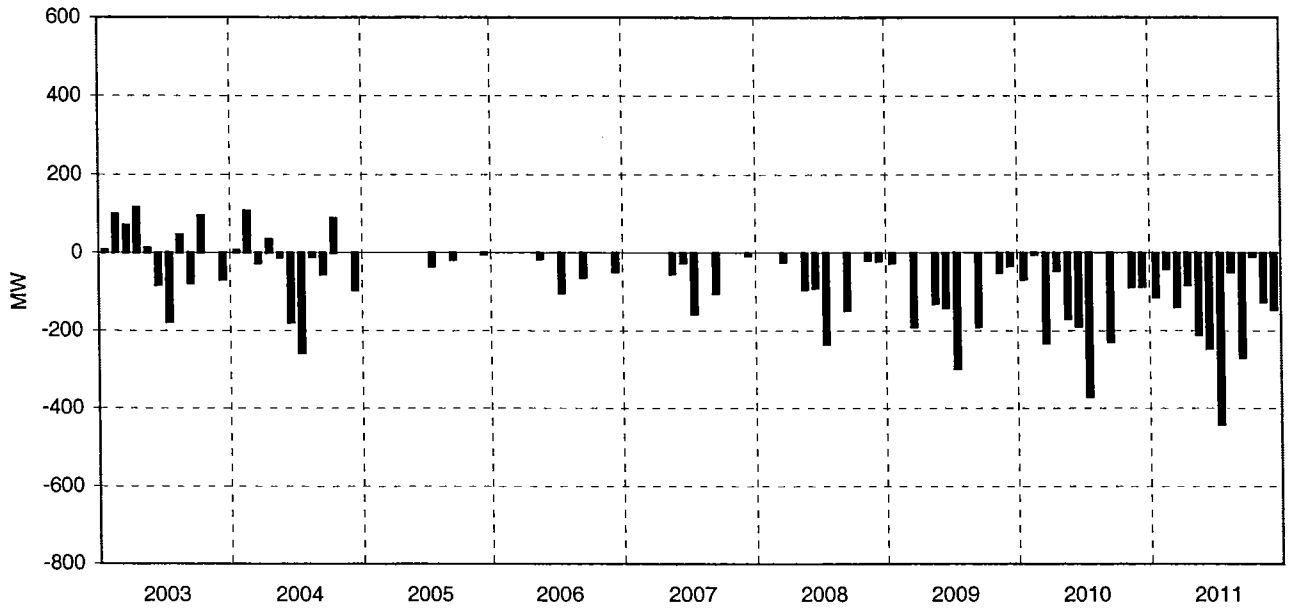
Monthly Energy Surplus/Deficiency
70th Percentile Water and Load, 2002 IRP Strategy 4 Resources with Garnet



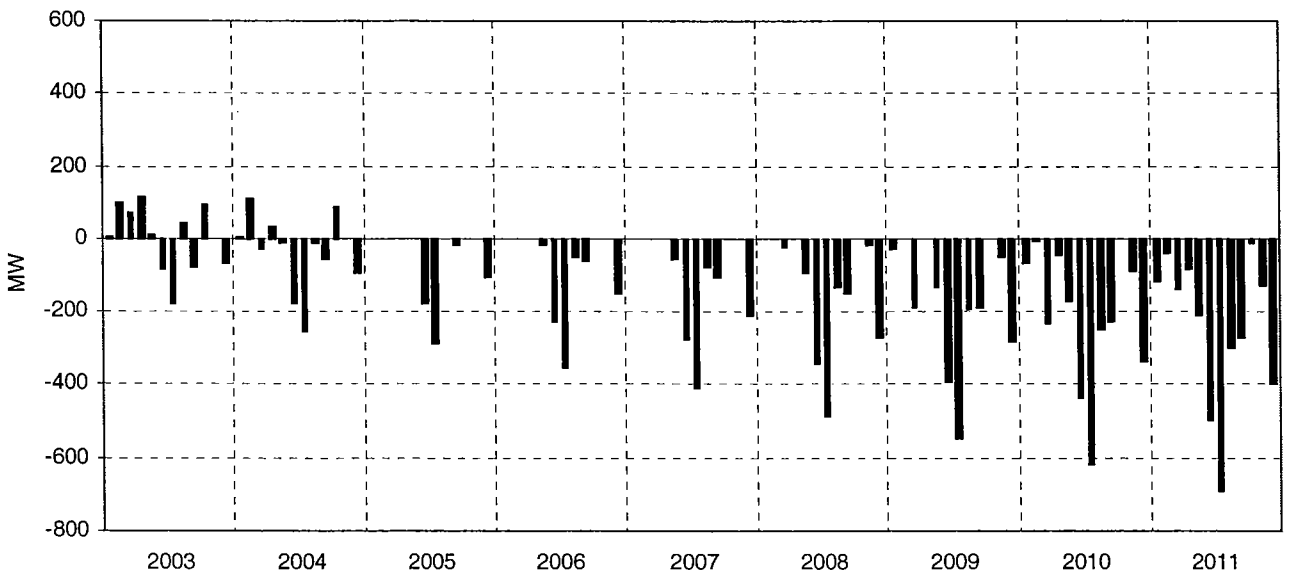
Monthly Energy Surplus/Deficiency
70th Percentile Water and Load, 2002 IRP Strategy 4 Resources without Garnet



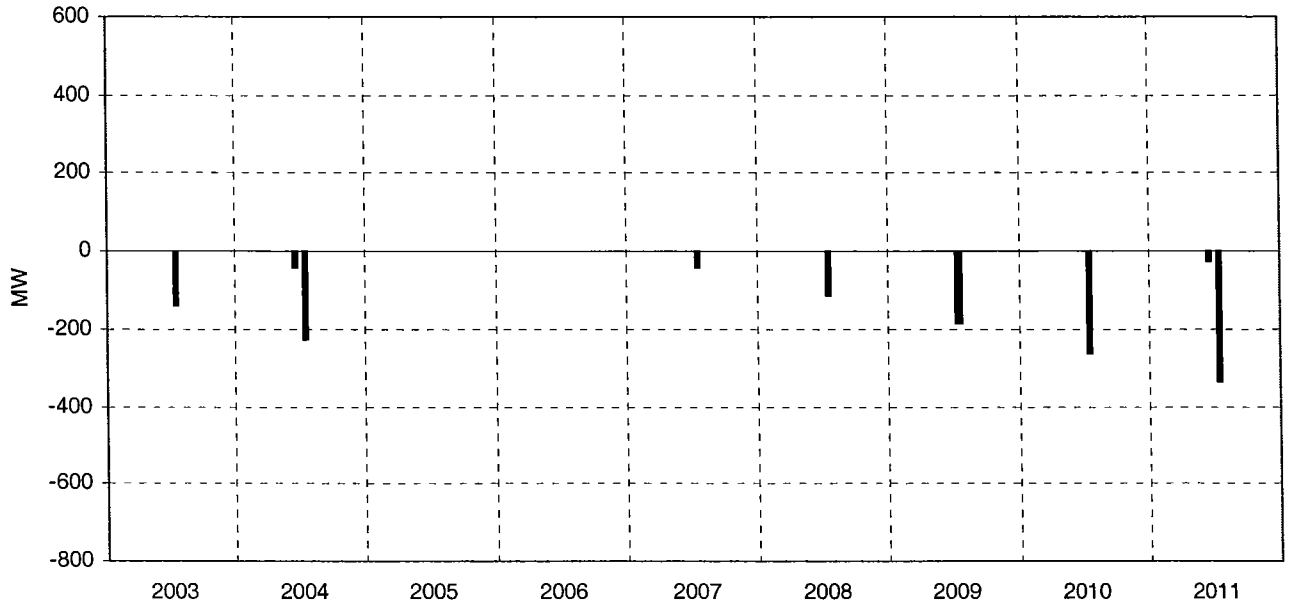
Monthly Peak Hour Surplus/Deficiency
90th Percentile Water, 70th Percentile Load, 2002 IRP Strategy 4 Resources with Garnet



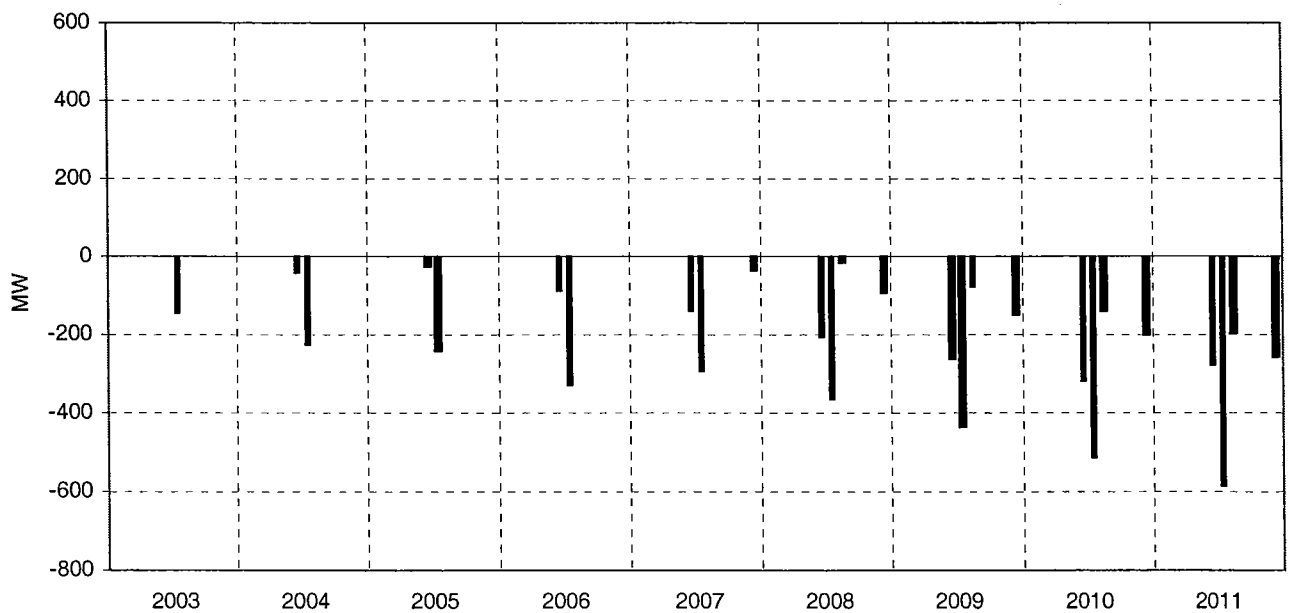
Monthly Peak Hour Surplus/Deficiency
90th Percentile Water, 70th Percentile Load, 2002 IRP Strategy 4 Resources without Garnet



Monthly NW Transmission Deficit - 90th Percentile Water, 70th Percentile Load, 2002 IRP
Strategy 4 Resources with Brownlee-Oxbow Transmission Upgrade and Garnet



Monthly NW Transmission Deficit - 90th Percentile Water, 70th Percentile Load, 2002 IRP
Strategy 4 Resources with Brownlee-Oxbow Transmission Upgrade and without Garnet



CONFIDENTIAL
This page allegedly contains trade secrets or confidential material and is separately filed.

Chapter
4

Alternatives Identified

Alternatives to Replace the Garnet PPA

Based on the assumption that the Garnet PPA is cancelled, Idaho Power Company has identified the following measures as potential alternatives to replace the Garnet PPA and to meet future resource needs:

- ***REDACTED***

- Build or acquire the output of additional generating facilities between the Borah West and Brownlee East constraints. This could include proposals one and three in Garnet's October 24, 2002 letter.
- Establish firm capacity and energy exchanges with other utilities.
- Secure seasonal firm wholesale purchases that can be delivered to Idaho Power without crossing the Northwest to Idaho path.
- Pursue demand-side measures that are cost effective for customers and the Company.
- Enter into firm purchases from regions other than the Pacific Northwest and simultaneously entering into non-firm interruptible off-system sales.
- Partner with another utility to build a jointly owned generation facility.

These alternatives focus on meeting Idaho Power's projected capacity and energy needs without increasing imports from the Pacific Northwest.

Additional Transmission & Power Purchase Agreements

REDACTED

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

Build Additional Generation Facilities Inside IPCo Service Territory

Several different generation facilities were investigated. The facilities considered were nominally sized as follows:

- 50 MW simple cycle combustion turbine
- 100 MW simple cycle combustion turbine
- 170 MW simple cycle combustion turbine
- 250 MW combined cycle combustion turbine
- 273 MW combined cycle combustion turbine

This distribution of sizes meshes with Idaho Power's current situation and other alternatives.

- The Evander Andrews Power Complex as currently configured can accommodate the addition of another 50 MW CT. Estimated costs for this unit were based on a GE LM6000 Sprint combustion turbine.

- A 100 MW simple cycle CT project is a useful building block size. For instance, if Idaho Power entered into an energy exchange and a wholesale purchase that totaled approximately 150 MW during the summer months, then an additional 100 MW would be required to reach the 250 MW provided under the Garnet PPA. Estimated costs for the 100 MW plant were based on two GE LM6000 Sprint combustion turbines. Additionally, at least one project developer has already provided Idaho Power with a proposal to develop a project in this size range.

- A 170 MW simple cycle CT is the approximate size of the CT used in a 250 MW combined cycle plant and is comparable to the turbine purchased for the Garnet facility. The unit could be initially operated as a simple cycle CT and then converted to a 250 MW combined cycle unit at a later date. This size of unit is compatible with a smaller combination of exchanges or firm wholesale purchases and will have a lower installed cost in $/kW. This option could be proposal three from Garnet's October 24, 2002 letter.

This page allegedly contains trade secrets or confidential material and is separately filed.

- The 250 MW combined cycle CT is a standard sized unit. Idaho Power's filing in the recent avoided cost case GNR-E-02-1 included a cost estimate for a 250 MW combined cycle plant to be constructed in the Boise area.

- The 273 MW combined cycle CT alternative is based on Idaho Power developing the Garnet project as described in proposal one in Garnet's October 24, 2002 letter.

Energy Exchanges

Seasonal energy exchanges have been a part of Idaho Power's portfolio for many years. Conceptually, an exchange is a great solution if adjacent systems have complementary needs. Unfortunately, with restructuring, and changes in ownership of regional utilities, interest in renewing exchange agreements has been limited. However, as noted in the 2002 IRP, Idaho Power has continued to investigate exchange opportunities. Benefits of energy exchanges include:

- No exposure to changes in market price for physical power.

- Reduced transmission costs for both parties if their systems are interconnected.

- Improving the resource utilization of each party.

REDACTED

Wholesale Purchase Contracts

REDACTED

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

CONFIDENTIAL
This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

Demand-Side Measures

As noted in the Near-Term Action Plan in the 2002 IRP, Idaho Power plans to integrate demand-side measures where economically feasible to address short duration peaks of the system load. The compact fluorescent light bulb, duct sealing, and funding for training of building operators programs are currently being implemented with input from the Energy Efficiency Advisory Group (EEAG). In addition, Idaho Power has identified two demand response programs that may be economically feasible. These are dispatchable direct load control programs targeted to manage capacity, not energy. The programs are: (1) Residential Air Conditioner Load Reduction Program and (2) Irrigation Peak Response Program. Idaho Power is currently analyzing the feasibility of a pilot program for each of these programs. If analysis shows that these programs are potentially viable, the irrigation pilot program could be in place for the summer of 2003. If the results from this pilot are favorable, full implementation could begin in the summer of 2005. The Residential Air Conditioner Load Reduction Program pilot could potentially be a two-year pilot beginning in the spring and summer of 2003. With good results, full implementation could begin in the summer of 2005.

As noted in the 2002 IRP, Idaho Power plans to integrate demand-side measures, where economically feasible, to address the short duration peaks of the system load. However, the revenue impacts associated with implementation of demand-side measures or conservation programs must be addressed in a manner equitable to both Idaho Power and its customers.

Interruptible Sales

In the 2002 IRP, Idaho Power identified a strategy to address projected summer peak hour loads in 2003 and beyond by making firm purchases from regions other than the Pacific Northwest and simultaneously entering into non-firm interruptible off-system sales. The combination provides Idaho Power with the ability to interrupt non-firm sales during critical peak-hour conditions and deliver the power to Idaho Power native load customers. Making interruptible sales is still an option and this strategy may be implemented at a later date.

Build a Jointly Owned Generation Facility

The development of a jointly owned plant was briefly explored with another entity. Idaho Power believes that the jointly owned development model merits further investigation for future energy needs considering the current state of the financial markets and the power industry. Unfortunately, it will

be difficult to (1) find an interested and qualified partner, and (2) develop the necessary project agreements within the time constraints necessary for a project to be considered as an alternative to the Garnet PPA.

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

Chapter **5**

Alternatives Evaluated

Analysis and Results

Analysis of Alternatives

Idaho Power Company's approach to analyzing and ranking the alternatives to replace the Garnet PPA relies on a combination of two analyses. First, the Aurora Electric Market Model was used to determine the impact of each alternative on net power supply costs (NPSC) from 2005 (when the Garnet PPA begins) through 2011, which is the last year included in the 2002 IRP. The NPSC for each alternative was then compared to the base case NPSC (based on the least-cost resource plan identified in the 2002 IRP without Garnet) to determine the change in NPSC resulting from the addition of each alternative. Since the alternatives analyzed with the Aurora model are not mutually exclusive, several were then combined to approximate the capacity provided by the Garnet PPA. The Aurora model was then rerun to determine the impact of the combined alternatives on NPSC. The NPSC estimates calculated in this analysis include both the fixed and variable costs associated with adding resources.

The second phase of the analysis examines impacts on the transmission system.

Discussion of Results

The analysis has identified the following four actions as Idaho Power's least cost alternatives. Reductions or increases in NPSC are relative to the base case (Base 2002 IRP w/o Garnet PPA) shown in Attachment 1. It is important to note that each action will be secured by a contract for firm power and each will be considered a firm resource in Idaho Power's power supply portfolio. Additionally, the reductions or increases in NPSC listed below and in Attachment 1 are based on differences between the expected future market-clearing price of power calculated by the Aurora model (for market purchases) and Idaho Power's current estimates of pricing that might be negotiated for the identified actions.

1. ***REDACTED***

CONFIDEI 'AL

This page allegedly contains trade secrets or confidential material and is separately filed.

2. ***REDACTED***

3. ***REDACTED***

4. ***REDACTED***

Given current market conditions, securing contracts for firm wholesale purchases and exchanges are Idaho Power's lowest cost options to replace the Garnet PPA. With forward market prices at current levels, financing for merchant facilities is questionable. Consequently, a number of power projects, like Garnet, are being cancelled. As substantiated in our analysis, given the projected market-clearing prices for electricity, building generation resources is not the least cost option at this time.

An exchange of energy and capacity between adjacent systems with complementary surpluses and deficits makes sense. The analysis identified exchanges as the lowest cost option. While the actual terms and conditions of the proposed exchanges and firm wholesale purchases have not been negotiated, the quantities assumed in the analysis for 2005 are shown below.

REDACTED

For comparison, capacity provided in the Garnet PPA is shown in the table below:

Garnet PPA Capacity (MW)

2005	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Garnet PPA						250	250	100				100

CONFIDENTIAL
This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

Market Price Uncertainty

While the analysis identifies firm wholesale purchase contracts and exchanges as the least cost alternatives, it is important to remember that the costs of such contracts and the value of exchanges are based upon certain assumptions with regard to estimated market prices and energy and transmission availability. It is also important to recognize that the recent events in the energy markets have severely diminished financial and physical liquidity in the marketplace. The lack of liquidity reduces price visibility in the forward energy markets making it difficult to estimate the cost of firm wholesale purchase contracts. The lack of visibility is compounded since the identified market alternatives are at illiquid delivery points on the WECC grid and are multiyear transactions. It is also difficult to determine if the market is adequate to supply the volume of energy required without driving prices upward. The estimated prices are also subject to changes in market conditions and the associated price volatility that may occur between now and the time the contracts are put in place. Therefore, until such time as Idaho Power consummates a contract with a potential supplier, the purchase price and resulting impact on NPSC cannot be assured.

Generation Resources

REDACTED

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

REDACTED

with deliveries beginning in 2003 to secure favorable terms, then Idaho Power will explore that option.

In addition to the Garnet PPA, the 2002 IRP also calls for a 100 MW peaking resource to be added in 2005. The Garnet Alternatives Analysis showed that the NPSC increase for a 168 MW CT and an 86 MW CT was approximately the same ***REDACTED*** over a 7-year period. Given the benefits to system reliability, Idaho Power will seriously consider increasing the size of the peaking resource it adds in 2005.

A summary of NPSC for the options analyzed is included in **Attachment 1**

CONFIDENTIAL
This page allegedly contains trade secrets or confidential material and is separately filed.

Chapter
6

Garnet Replacement Strategy

Proposed Strategy to Replace Garnet PPA

Strategy Details

REDACTED

The strategy can be executed in steps. If the entire amount of capacity necessary to replace the Garnet PPA cannot be acquired under favorable terms and conditions from the market, then internal generation resources can be added as required to match the capacity provided under the Garnet PPA.

Generation resources built under PURPA guidelines will also add generation to Idaho Power's system in the future. Idaho Power cannot foresee the number of PURPA projects that will be built as a result of IPUC Case No. GNR-E-02-1 and Order No. 29124. The uncertainty is a problem. Idaho Power is required to offer 20-year contracts for the output of Qualifying Facilities (QF) at recently established avoided cost rates. The proposed firm wholesale purchase solution is one way to compensate for this uncertainty. If firm wholesale purchases are structured with an initial term and an option to extend, then the uncertainty can be at least partially addressed with a renewal option. If a number of QF projects are

constructed in the near-term, then it may not be necessary to extend the firm wholesale purchases.

REDACTED

Strategy:

Proceed with firm wholesale purchase contract solution. Negotiate firm exchange and wholesale power purchase agreements. Incorporate flexibility in contracts and attempt to negotiate contracts at current price levels.

This page allegedly contains trade secrets or confidential material and is separately filed.

- ***REDACTED***
- ***REDACTED***
- Issue an RFP for at least 100 MW of peaking capacity, which is to be available in 2005 as outlined in the 2002 IRP. The 100 MW of capacity is in addition to the Garnet PPA replacement resources. Results of this Garnet Alternatives Analysis indicate that it may be possible to add 168 MW of peaking capacity for little or no additional cost (as compared to a 100 MW peaking resource). Given the benefits to system reliability, Idaho Power is seriously considering increasing the RFP to approximately 170 MW. The Garnet site is a potential site for this resource and the Garnet equipment could be used if it is the least expensive.
- If unsuccessful in negotiating acceptable contracts, increase the amount of peaking capacity requested in the RFP. The amount of capacity will depend on results of the exchange and firm wholesale purchase alternatives.
- Idaho Power will keep the IPUC Staff informed of its progress in negotiating firm exchange and wholesale power purchase agreements.

CONFIDENTIAL

This page allegedly contains trade secrets or confidential material and is separately filed.

Chapter **7**

Action Plan

Given current forward prices and estimates of future market-clearing prices, the recommended replacement for the Garnet PPA is a combination of firm wholesale purchases and exchanges. Successful negotiation and execution of firm wholesale power purchase and exchange agreements prior to any major changes in the forward prices is critical to the success of this strategy. If current forward prices increase substantially, or if the current estimates of future market-clearing prices increase substantially, then adding additional generation resources may become the preferred strategy.

Idaho Power will attempt to negotiate firm exchange and firm wholesale power purchase agreements with an initial term of 5 years, beginning in 2005. However, if it is necessary to enter into an agreement with deliveries beginning in 2003 to secure favorable terms, then Idaho Power will explore that option. Ideally, the agreements will incorporate provisions for a renewal term at Idaho Power's option. Idaho Power's proposed steps for implementing this strategy are:

1) ***REDACTED***

2) ***REDACTED***

3) ***REDACTED***

4) ***REDACTED***

5) Issue an RFP for 100 MW to 170 MW of peaking resource to be on-line in 2005. Encourage bidders to identify added value options they can provide such as bringing project on-line early if necessary, or adding additional capacity. Depending on response to the ***REDACTED*** and outcome of the firm wholesale purchase and exchange negotiations, the 100 MW peaking resource identified in the 2002 IRP may be adjusted upward.

GARNET ENERGY LLC

PO Box 7867
Boise, Idaho 83707
3380 Americana Terrace, Suite 300
Boise, Idaho 83706
ph 208.395.8930
fax 208.395.8931

October 24, 2002

J. LaMont Keen
President
Idaho Power Company
1221 West Idaho Street
Boise, Idaho 83702

Re: ***Garnet Energy Facility***

Dear LaMont:

On December 14, 2001, (i) Garnet Energy LLC ("Garnet") and Idaho Power Company ("Idaho Power") entered into a Power Purchase Agreement (the "Agreement") pursuant to which, among other things, Idaho Power agreed to purchase, and Garnet agreed to sell, certain capacity and energy associated with the nominal 270 MW Garnet Energy Facility to be located near Middleton, Idaho (the "Facility") during peak load hours in the months of June, July, August and December for an initial term of five years commencing in 2004 and, at Idaho Power's election, for five one-year renewal terms thereafter, and (ii) Idaho Power filed the Agreement and ancillary documents with the Idaho Public Utilities Commission ("IPUC") seeking, among other things, an accounting order allowing Idaho Power to include the expenses of buying capacity and energy from Garnet in its power cost adjustment. On April 15, 2002, Idaho Power exercised its option under Section 4.4.1 of the Agreement to delay the "Guaranteed Commercial Operation Date" (as defined in Section 1.26 of the Agreement) of the Facility until June 1, 2005, representing a delay of one year. Subsequently, on June 14, 2002, Garnet and Idaho Power entered into a First Amendment to the Agreement to reflect the impact of such delay on certain terms and conditions of the Agreement. The Agreement, as amended by such First Amendment, is referred to in this letter as the "PPA".

Several parties, including Garnet, intervened in the IPUC proceeding regarding the PPA. Following several months of production requests, responses to such requests, motions, and submission of written testimony by the parties, including the IPUC staff, the IPUC scheduled a hearing for July 23, 24 and 26, 2002. On July 22, 2002, Idaho Power filed a motion with the IPUC requesting that the hearing be vacated for an indefinite period but not less than 120 days, citing financing difficulties for the Facility given recent turmoil in the financial markets and the energy sector. Upon motion by other parties in the case, the IPUC dismissed the case without prejudice. In addition, noting that Idaho Power's 2002 Integrated Resource Plan ("IRP") assumes the Facility as a resource, should the Facility no longer be viable, the IPUC ordered Idaho

Power to present to the IPUC a report or plan for satisfying identified energy and peak load deficits or a suggested procedure to identify such options. This report is due on October 30, 2002.

The purpose of this letter is to reiterate Garnet's alternative proposals presented to you on September 17, 2002. If selected, any of these proposals would allow Idaho Power to include the Facility or related assets as a resource in its report or plan for satisfying identified energy and peak load deficits. Before addressing such proposals, however, this letter will briefly discuss the circumstances currently hindering the financing of power plants in the United States.

Power Plant Financing

The well publicized collapse of energy giant Enron Corp. last year and the costly meltdown of California's deregulated power market presaged the U.S. electric power industry's worst credit crunch since the Great Depression,[1] and the crunch is likely to get worse as billions of dollars of debt for recently constructed power plants will need to be refinanced in coming months.[2] A leading credit-rating agency, Standard & Poor's, said that in the first nine months of 2002, there were 135 credit downgrades of utility holding companies and their subsidiaries, nearly quadruple the number in the year-earlier period, of which 57, or 42%, have occurred since July.[3] With nearly one-third of the major companies in the sector on watch for future downgrades, it appears the industry has not yet hit bottom. In an effort to avoid further downgrades in their credit status, several companies with wholesale power trading and marketing units, including Dynegy, Aquila and IDACORP, have exited that line of business altogether.

With the disintegration of wholesale energy prices and the resulting reduction of cash flows, companies are finding it more difficult and expensive to roll over debt and to complete capital-intensive new generation projects. With less capital market support, some companies have been forced to sell assets in order to reduce debt levels and improve their credit quality.[4] Other companies have been compelled to announce delays or cancellations of construction of new power plants, with such announcements

---

[1] Rebecca Smith, *Electric Industry Hits Credit Crisis*, WALL ST. J., Oct. 15, 2002, at A2 ("Credit Crisis").

[2] On September 6, 2002, Standard & Poor's issued a report finding that most companies that recently built power plants are at risk to refinance about $30 billion to $50 billion of construction or mini-perm obligations that mature from 2003 to 2006. *See S&P Sees New Refinancing Risk for Ailing Merchant Industry*, MEGAWATTDAILY, Sept. 9, 2002, at 9. Mini-perm financings are typically used as a tool for income-producing projects that need to establish operating history prior to obtaining long-term or permanent financing. S&P views the refinancing of mini-perm debt as one of the largest risks facing many of the energy merchants and believes that if weak market conditions continue, the ability to refinance these loans may prove challenging. *See id.*

[3] Credit Crisis, *supra* note 1.

[4] *See, e.g., Williams Sells Assets, Secures Financing to Make Great Escape*, MEGAWATTDAILY, Aug. 2, 2002, at 1 (Williams secures $1.4 billion of net proceeds from asset sales); *NRG to Speed Asset Sales to Stay Solvent*, MEGAWATTDAILY, Aug. 22, 2002, at 1 (NRG must speed up sale of generating assets to stay solvent); *S&P Cuts Mirant Below Investment Grade, Noting Asset Sales*, MEGAWATTDAILY, Oct. 22, 2002, at 1 (Mirant depending on asset sales to bolster balance sheet).

occurring almost daily in the past few months.[5] In fact, even some of the industry's financially strongest companies are announcing cut backs in generation projects. For example, citing a "dramatic and consistent" decline in wholesale power prices, on August 21, 2002, industry leader Duke Energy said it was suspending or slowing work on projects totaling 3,600 MW.[6] Based on Garnet's discussions with several institutions active in the financing of power projects, this announcement sent shockwaves through the financial community, particularly because Duke actually suspended construction of two 600 MW gas-fired plants in Washington and New Mexico that were about 40% complete and were expected to go on-line in mid-2003. Lenders are concerned that, if other projects under construction suffer a similar fate, defaults could be declared under large construction loans provided on a project specific (non-recourse) basis, leaving the lenders with foreclosure against partially constructed, non-operating assets as their only remedy.

It is common knowledge that major power companies' stock prices have tumbled significantly over recent months, resulting in the staggering loss of industry-wide market capitalization exceeding $100 billion since the beginning of 2002 and nearly wiping out the equity value of many of the industry's leading companies, such as Dynegy and Calpine to name only two victims of these circumstances. IDACORP has not been immune from this dramatic decline in market capitalization. In April 2002, IDACORP's stock price exceeded $40 per share. Today, it hovers in the range of $22 to $25 per share, a decline of equity value well in excess of $500 million.

This massive loss of equity value, coupled with the financial community's tightening of lending terms as rating agencies have been downgrading the ratings of power companies, has made it extremely difficult to borrow money for the construction of power plants, particularly those plants that do not have all or a substantial portion of their output sold to credit-worthy third parties under long-term contracts. A prolonged

---

[5] *See, e.g., Cogentrix Not Looking for New Merger Deal After Aquila Failed*, MEGAWATTDAILY, Aug. 7, 2002, at 2 (two Ohio merchant gas-fired plants with total capacity of 2,300 MW placed on hold due to negative market conditions); *Rapids Power Cancels 225-MW Plant for Minn.*, MEGAWATTDAILY, Aug, 7, 2002, at 2 (225 MW cogeneration project in Minnesota cancelled due to slumping power market); Benjamin Shors, *Deadline Passes for Power Plant Appeal*, THE SPOKESMAN-REVIEW, Aug. 2, 2002, at A1 (Newport Generation shelves 1,300 MW gas-fired plant for Rathdrum Prairie); Benjamin Shors, *Cogentrix Won't Appeal Permit Denial*, THE SPOKESMAN-REVIEW, Aug. 1, 2002, at A1 (Cogentrix tables 820 MW gas-fired plant at Rathdrum Prairie, citing deflated energy market); *Calpine Not Building Calif. Plant Without Contract*, MEGAWATTDAILY, Sept. 16, 2002, at 1 (despite approval to construct issued by California Energy Commission, previously aggressive merchant generator, Calpine, will not construct 600 MW gas-fired plant without long-term contract for all the plant's output, citing current negative market conditions as obstacle to construction); *Aquila Scraps Plans to Build 320-MW Ohio Unit*, MEGAWATTDAILY, Sept. 25, 2002, at 1 (blaming changing market conditions, Aquila cancels 320 MW gas-fired plant in Ohio); *DPL Cancels 300-MW Peaker in Ohio*, MEGAWATTDAILY, Sept. 27, at 2 (DPL Energy cancels 300 MW gas-fired plant, stating plant is not viable given current financial and market conditions); *Cogentrix Pulls Ore. Application for Grizzly Plant*, MEGAWATTDAILY, Oct. 2, 2002, at 7 (citing negative market conditions, Cogentrix places on hold 980 MW gas-fired plant in Oregon); *Kinder Morgan Suspends Plans for Two 560-MW Va. Plants*, MEGAWATTDAILY, Oct. 23, 2002, at 2 (two gas-fired plants in Virginia totaling 1,120 MW suspended due to "softness" in power markets); *PSEG Delays Construction of Three Merchant Plants*, MEGAWATTDAILY, Oct. 23, 2002, at 8 (PSEG delays construction schedule of three gas-fired plants in Indiana, New Jersey and New York totaling 3,086 MW, citing weak economy and reduced power demand).

[6] *Blaming Markets, Duke Suspends, Slows Work on 3,600 MW*, MEGAWATTDAILY, Aug. 21, 2002, at 1.

economic downturn in the United States and a precipitous decline in spark spreads and price volatility in both the spot and forward markets for power have further exacerbated these financing difficulties. Also, continuing regulatory investigations of various players in the industry (and the uncertainty associated with the potential outcome of those investigations) and government intervention in the markets have given potential project lenders even more reason to avoid providing capital to the sector.

In short, all of the foregoing factors have acted in concert to make the successful financing of the Facility on acceptable terms under the existing PPA impracticable. At the time Idaho Power and Garnet entered into their existing power purchase arrangements, neither party anticipated these circumstances would occur. These external factors (which have actually worsened significantly since Idaho Power moved to vacate the IPUC hearings on the PPA in July) are beyond the control of either party.

Garnet has held discussions with a multitude of banks and other institutions regarding their interest in providing financing (both debt and equity) for the Facility. As recently as a few months ago, many of these parties eagerly awaited the chance to participate in the financing for the Facility (originally planned to close in the spring of 2003) on acceptable terms, despite the fact that the PPA (as currently drafted) would require Garnet to assume a large measure of merchant risk. However, as circumstances described above have unfolded over the past few months, this eagerness has been overtaken by deep concern for the merchant risk associated with the Facility, resulting in the prospect of untenable terms and conditions for Garnet's access to capital if such merchant risk is not mitigated.[7] Regardless of this shift in financing prospects, Garnet would be able to obtain acceptable financing for the Facility if Idaho Power selects Proposal Two below.

Garnet's Alternative Proposals to Preserve Facility as Resource Option

Despite these daunting challenges, Garnet believes that the Facility is needed, not only to meet the power supply requirements of Idaho Power as outlined in the IRP but also to address projected deficits in the Northwest Region's power supplies in the next few years.[8] Accordingly, Garnet has worked diligently to complete the permitting and development of the Facility and has devised the following alternative proposals that, if any option is selected, would allow Idaho Power to derive power supply benefits from Garnet's efforts. Idaho Power may select any one of the following options at its discretion.

---

[7] According to Ralph Cavanagh, senior attorney with the Natural Resources Defense Council, "The old merchant generation model cannot deliver today," noting that builders of new plants would need the kind of backing provided by long-term contracts with local utilities. Nigel Hunt, *U.S. Seen Not Facing Power Glut Despite Low Prices*, REUTERS, Oct. 21, 2002.

[8] *See, e.g., id.* (at Edison Electric Institute financial conference held in Palm Desert, California in October 2002, panel including federal energy regulator Nora Mead Brownell, state regulators from Idaho and California and executive from merchant generator company "all agreed there was no excess of megawatts in the market"); BONNEVILLE POWER ADMINISTRATION, 2000 PACIFIC NORTHWEST LOADS AND RESOURCES STUDY (WHITE BOOK), updated May 1, 2002, at Part 4 (showing significant power supply deficits for region beginning in next few years).