

SCOTT WOODBURY  
DEPUTY ATTORNEY GENERAL  
IDAHO PUBLIC UTILITIES COMMISSION  
472 WEST WASHINGTON STREET  
PO BOX 83720  
BOISE, IDAHO 83720-0074  
(208) 334-0320  
BAR NO. 1895

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IDAHO PUBLIC  
UTILITIES COMMISSION

Street Address for Express Mail:  
472 W. WASHINGTON  
BOISE, IDAHO 83702-5983

Attorney for the Commission Staff

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

**IN THE MATTER OF THE APPLICATION OF )**  
**IDAHO POWER COMPANY FOR AN )** **CASE NO. IPC-E-03-8**  
**ACCOUNTING ORDER AUTHORIZING )**  
**INCLUSION OF POWER SUPPLY EXPENSES )**  
**ASSOCIATED WITH THE PURCHASE, )** **COMMENTS OF THE**  
**PROFIT CAPACITY AND ENERGY FROM PPL )** **COMMISSION STAFF**  
**MONTANA, LLC IN THE POWER COST )**  
**ADJUSTMENT. )**

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**COMES NOW** the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Notice of Application, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued on May 23, 2003, submits the following comments.

**BACKGROUND**

On May 13, 2003, Idaho Power Company (Idaho Power; Company) filed an Application with the Commission for an Order approving a Power Purchase Agreement (Agreement; PPA) between Idaho Power and PPL Montana, LLC (PPL Montana). The Company requests accounting treatment that will allow Idaho Power to include the expenses associated with the

purchase of capacity and energy from PPL Montana, LLC in the Company's Power Cost Adjustment (PCA).

Idaho Power in its Application recounts its failed attempt to secure from its affiliate the seasonal energy deficiencies and peak hour transmission constrained deficiencies identified in its 2000 Integrated Resource Plan (IRP). Reference the proposed Ida West Garnet 250 MW (Middleton) natural gas combustion turbine. In the Garnet Report provided to the Commission on October 30, 2002, the Company announced its plan to replace the Garnet Power Purchase Agreement with a combination of alternatives, including firm wholesale purchases and exchanges.

In conformance with the replacement strategy identified in the Garnet Report, Idaho Power reports that it has successfully negotiated a firm wholesale Power Purchase Agreement with PPL Montana, LLC. Contracting with PPL Montana is advantageous, the Company contends, because existing transmission constraints on the west side of Idaho Power's system made power purchases on the east side of the Company's system preferable.

The principal provisions of the Power Purchase Agreement with PPL Montana call for a firm power purchase for the heavy load hours, six days a week, 16 hours a day (6 x 16) in the months of June, July and August. These are the time periods identified in the Company's 2002 IRP as the times of peak resource need on Idaho Power's system. The term of the Agreement is June 1 through August 31 of each year beginning in 2004 and ending in 2009. The quantity of energy purchased is 83 MW per hour, except for the month of August 2004, which shall be 26 MW per hour. The price to be paid for this energy is \$44.50 per MWh. After adjusting for losses, and with the exception of the August 2004 time period, Idaho Power will actually receive approximately 80 MW per hour under the PPA.

## **ANALYSIS**

Idaho Power's need for new resources was identified in its 2002 Integrated Resources Plan (IRP). Staff concurred with the Company's assessment of its need for new resources as identified in the IRP and supported the subsequent issuance of a Request for Proposals. To satisfy the need identified in the IRP, the Company proposed to acquire the output from the Garnet project during four months of the year, for an initial five-year term beginning in June 2004. However, because the Garnet project has been abandoned, Staff believes that the need for

new resources still exists.

Idaho Power states that the proposed PPL Montana Agreement is part of the Company's strategy to replace the 250 MW of capacity that was lost when the Garnet project was abandoned. In its October 30, 2002 "Report to the IPUC on Replacing the Garnet Power Purchase Agreement" (Garnet Report), Idaho Power described a strategy consisting of acquiring firm transmission rights, firm wholesale purchases and 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. Staff believes that this proposed Agreement is consistent with the Company's plans as identified in the Garnet Report.

The Company contends that the energy cost of \$44.50 per MWh is competitive and favorable when compared to alternative resource options. In the testimony of Greg Said filed with the Company's Application, the proposed contract price was compared to current avoided costs for energy purchases from small QFs, to market prices with added transmission costs, to estimated power costs under the now defunct Garnet contract and to costs of Idaho Power's Mountain Home (Danskin) plant. Staff reviewed these comparisons and also completed its own analysis to evaluate the reasonableness of the proposed contract price.

### **Comparison to Avoided Cost Rates**

As reflected in the Company's prefiled testimony,

Idaho Power's current avoided costs for small QFs are determined by the IPUC in Order No. 29124 are based upon a Surrogate Avoided Resource of a 230 MW combined cycle combustion turbine and were set September 26, 2002. The levelized rate for a non-fueled project smaller than 10 MW, coming on line in the year 2004 for a contract length of five years is 43.78 mills/kWh (\$43.78 per MWh). The levelized rate for a 20-year contract (a more likely scenario for a QF contract) is \$49.83/MWh. The PPA rate of \$44.50/MWh for a peak hour summer peak power product compares favorably to non-seasonalized QF contract rates. All of Idaho Power's existing QF contracts use "seasonalized" rates which provide significantly higher purchase prices in the summer months.

Staff agrees with Idaho Power's comparison to avoided cost rates, but notes that avoided cost rates are based on estimated costs for a base load plant. Power during heavy load hours (i.e., 6 x 16) is always worth more than a flat product (i.e., 7 x 24) such as would be provided by the SAR upon which avoided cost rates are

based. An avoided cost rate for hours equivalent to those in the proposed Agreement would certainly exceed the \$43.78 per MWh stated above.

In addition, the avoided cost rates referred to above by Idaho Power were computed using gas prices that are substantially lower than gas prices today and lower than what gas prices are expected to be in the next few years. In order to provide a more valid comparison, Staff computed avoided cost rates using June 2, 2003 NYMEX futures prices for the term of the proposed Agreement. The resulting rate for a six-year levelized contract beginning in 2004 is \$49.84 per MWh (49.84 mills per kWh).

### **Comparison to Garnet Contract**

Staff believes Idaho Power's comparison to the cost of the now defunct Garnet contract has some validity, particularly because the Garnet contract was generally intended to satisfy load during similar summertime heavy load hour conditions as power under the Agreement. Staff estimated the price of power under the Garnet contract to be nearly \$77 per MWh over a ten-year period of time assuming gas prices of \$3.75 per MMBtu. Higher gas prices would obviously cause power under the Garnet contract to be even more expensive. A direct comparison between Garnet and the PPL Montana Agreement, however, cannot be made because the Garnet contract would have exceeded the length of the PPL Montana Agreement and because the Garnet contract included delivery of power in months different from the PPL Montana Agreement. Furthermore, gas prices are different now than were forecast when the Garnet contract was being considered. Nevertheless, the fact that the price under the PPL Montana Agreement is so much less than the expected cost of power under the Garnet contract does provide some redundant assurance that the price of the PPL Montana Agreement is reasonable.

### **Comparison to Mountain Home**

Idaho Power also compared the cost of this proposed Agreement to the cost of power from its Mountain Home (Danskin) project. For the coming summer, with gas purchases made for June and July at \$4.55 and \$4.71 respectively, the operating cost

of the Mountain Home plant is projected to be \$57.85 per MWh for June and \$59.16 per MWh for July. Although it will most likely be necessary for the Company to need power from the Mountain Home plant and from the PPL Montana contract at the same time, at \$44.50 per MWh, power under the PPL Montana Agreement is much cheaper and would displace power from Mountain Home whenever possible. Note also that the prices cited for the Mountain Home plant are comprised only of fuel, start-up costs and variable O&M and do not include any capital recovery or fixed O&M costs.

### **Comparison to Forward Prices**

In testimony accompanying its Application, Idaho Power compared the cost under the PPL Montana Agreement to current forward market prices. The Company stated:

On May 8, 2003, forward market bid/offer quotes at Mid-Columbia for Q-3, 2003, heavy load hours, were \$45.50/MWh and \$46.50/MWh, respectively. Bid/offer quotes for the same quotes at Palo Verde were \$62/MWh and \$64.25/MWh, respectively. With an energy purchase at either of these hubs, additional costs would be incurred for transmission to the Idaho Power system. It should be noted that transmission from Mid-Columbia, if available, would need to be routed through the northern part of the regional inter-connected transmission grid since the Idaho Power transmission system is constrained from the west.

For a better comparison, Staff compared the proposed price under this Agreement to forward market prices over more than just a single day. Idaho Power constructs forward curves on a frequent basis using information gathered by its traders from a variety of brokers. These forward curves indicate the price at which Idaho Power believes various products can be purchased from the market. Staff obtained from Idaho Power its forward curves constructed on one day in February, March and April, and for two different days in May for a heavy load hour product for delivery June through August in 2004 – 2009. The forward curve information was submitted as confidential, therefore, the information is not included with these comments. As expected, forward curve prices have varied over the past several months, but not substantially. The Company's commitment on May 9, 2003 to a price of \$44.50, was not the lowest or the highest price during the period, but was within a reasonable range.

## Comparison to AURORA Prices

Staff used the AURORA model to generate estimated prices for the period of the proposed Agreement to use as an additional point of comparison. AURORA is an hourly production cost model that dispatches resources to a given set of market conditions and also develops a set of market prices responsive to varying levels of regional load, natural gas prices and hydroelectric conditions. Area prices are computed on an hourly basis by comparing loads to the dispatch costs of available resources, considering transmission constraints. AURORA computes prices based strictly on fundamentals, and cannot predict price excursions that sometimes occur for other reasons. The entire Western Electricity Coordinating Council (WECC) area was considered in computing prices.

For the analysis, Staff used average natural gas futures prices through 2009 as published by NYMEX on June 2, 2003, the day before the analysis was done. These prices reflect the current high natural gas prices that are expected to persist for several more years. Prices are expected to continue to be high in 2003 and 2004 due to currently drawn down storage inventories and lack of development of new supplies. The need to fill storage reservoirs, combined with summer gas demands from new electricity generating plants, is expected to strain gas supplies during the rest of 2003 and possibly into 2004. By 2005 prices are expected to have moderated but remain well above price levels of the 1990s. The June 2, 2003 NYMEX gas prices used in the analysis are fairly representative of prices that have persisted for the remainder of the current month of June. These NYMEX prices slightly exceed the Northwest Power Planning Council's "high" price forecast contained in the April 22, 2003 revised draft of their fuel price forecasts for the Fifth Power Plan.

The results of Staff's AURORA modeling are shown in Attachment 1. The jagged line represents projected hourly heavy load hour prices for southern Idaho from June 1, 2004 through August 31, 2009, the term of the proposed Agreement. The shaded bands identify the months during which energy will be provided under the Agreement. The average heavy load hour price for only the months of June – August during the period of 2004 – 2009 is \$50.20 per MWh. The levelized price for the same hours during the same period is \$46.85 per MWh. Staff believes this levelized price is the fairest comparison to the proposed price of \$44.50 in the Agreement. The difference between the proposed contract price and the AURORA price is approximately five percent.

The AURORA prices are heavily dependent on the gas price assumptions used in the analysis. Staff believes that the gas prices it used are realistic, and represent prices at which gas is currently being bought and sold for the period. Actual gas prices during the period could obviously turn out to be higher or lower than the prices used for the analysis.

### **Conclusions on the Proposed Price**

By all comparisons — avoided cost rates, Garnet contract prices, costs of operating Mountain Home, forward market prices, and AURORA analysis — the proposed price in the Agreement appears to be reasonable. The proposed price is significantly less than the Commission's avoided cost rates and below costs that would have been incurred under the Garnet contract. The proposed contract rate is also in the range of Idaho Power's forward market prices and slightly below AURORA's predicted market prices.

### **PCA Treatment**

Idaho Power proposes that costs associated with acquiring firm monthly transmission service from Northwestern Energy's transmission system be booked in FERC Account 565, Transmission of Electricity by Others. These monthly transmission costs currently do not flow through the Company's Power Cost Adjustment (PCA). Idaho Power proposes that the cost for power acquired through the Montana PPL Agreement be booked in FERC Account 555, Purchased Power, and that the costs upon contract approval flow through the Company's PCA. Until the costs of the contract are included in a general revenue proceeding, any contract costs associated with the Agreement will be considered deviation from the base and, therefore, only 90% of the Idaho jurisdictional costs will be borne by customers.

Staff believes the proposed PCA treatment is proper. The addition of the PPL Montana resource will automatically cause changes in the accounts used to calculate monthly PCA deferrals. The resource addition will cause a decrease in other purchased power costs, a decrease in fuel costs and an increase in secondary sales revenue. These differences all benefit ratepayers. It is unfair to pass the PCA benefits to ratepayers without also passing on the costs. Until Idaho Power's next general revenue requirement proceeding, 90 percent of contract costs and 90 percent of PCA benefits will flow through the PCA to Idaho customers.

## **Transmission**

In order for power to be delivered, Idaho Power will need to acquire firm monthly transmission capacity from NorthWestern Energy. Staff is aware of industry and media speculation that NorthWestern Energy's parent, NorthWestern Corp., could potentially file for bankruptcy. In the event a bankruptcy filing is made, the likelihood is that NorthWestern Energy would retain its assets and continue to operate the company. Staff believes NorthWestern Energy would continue to be required to honor its transmission contracts at FERC-approved rates. Staff also believes that a bankruptcy filing would not cause any delays in NorthWestern's ability to sign new transmission contracts or perform under them.

## **Other Alternatives**

Staff is convinced that the proposed Agreement represents the least cost supply-side option for meeting peak hour summertime load requirements. The proposed Agreement may, in fact, be the least cost of any options, either supply-side or demand-side. However, Idaho Power's need to acquire power during only heavy load hours during only three months of the year underscores the rather limited nature of the Company's deficit. Staff strongly believes that a variety of demand-side programs should seriously be investigated to potentially reduce peak summertime loads. Traditional demand-side management, voluntary curtailment programs, interruptible rates and time-of-use rates are just some of the possible mechanisms that might be employed to reduce or eliminate the Company's need to acquire additional supply-side resources in the future. In addition, these types of mechanisms could reduce the need to operate the Company's Mountain Home (Danskin) plant, a plant whose fuel and variable O&M costs alone far exceed the costs of the proposed PPL Montana contract.

Idaho Power admits that air conditioning and irrigation loads are the major contributors to its peak summertime load. Staff believes it would make sense to design demand-side management programs to specifically target these sectors. To its credit, Idaho Power is implementing a pilot air conditioner cycling program intended to reduce summertime peak loads. The Company also has a small time-of-use pilot program for its irrigation customers, although it appears the Company has no plans to continue or expand the program. Staff believes Idaho Power should make a more sincere effort to consider demand-side options when cost effective and to give proper credit to the ability of demand-side programs to avoid or defer the need to

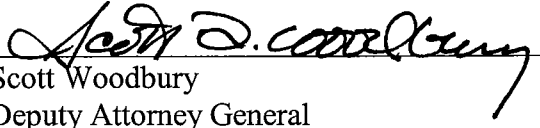


acquire new generation. Staff is concerned that the Company fails to acknowledge and quantify the value of avoiding future peaking generation as a result of peak hour load reduction in its irrigation time-of-use pilot, despite repeated Staff requests to do so.

## RECOMMENDATIONS

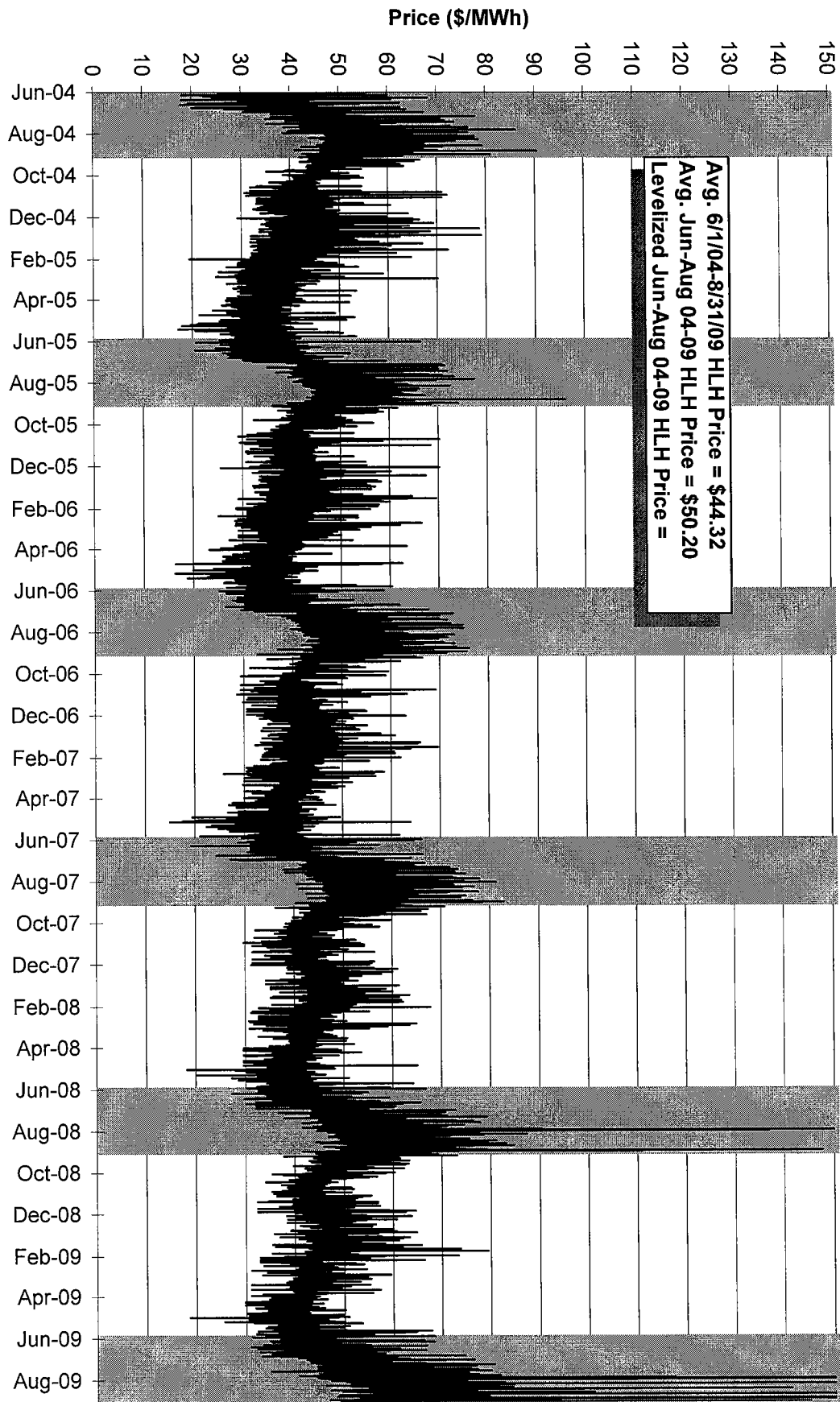
Staff recommends approval of the Agreement as filed. Staff also agrees with Idaho Power's proposed PCA treatment.

Respectfully submitted this 27<sup>th</sup> day of June 2003.

  
Scott Woodbury  
Deputy Attorney General

Technical Staff: Rick Sterling

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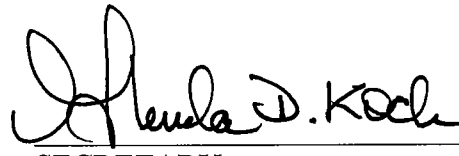
**Southern Idaho Heavy Load Hour Prices**  
 Output from AURORA modeling using 6/3/03 natural gas futures prices

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 27<sup>th</sup> DAY OF JUNE 2003, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. IPC-E-03-8, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

BARTON L KLINE  
SENIOR ATTORNEY  
IDAHO POWER COMPANY  
PO BOX 70  
BOISE, ID 83707-0070

JOHN P PRESCOTT  
VICE PRESIDENT – POWER SUPPLY  
IDAHO POWER COMPANY  
PO BOX 70  
BOISE, ID 83707-0070

  
\_\_\_\_\_  
SECRETARY