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Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)	
IDAHO POWER COMPANY FOR APPROVAL)	CASE NO. IPC-E-04-5
OF AN AGREEMENT FOR SALE AND)	
PURCHASE OF ELECTRIC ENERGY)	
BETWEEN IDAHO POWER COMPANY AND)	COMMENTS OF THE
RENEWABLE ENERGY OF IDAHO, INC.)	COMMISSION STAFF
)	

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 March 16, 2004 submits the following comments.

BACKGROUND

On February 19, 2004, Idaho Power Company (Idaho Power; Company) filed an Application with the Idaho Public Utilities Commission (Commission) requesting approval of a Firm Energy Sales Agreement (Agreement) between Idaho Power and Renewable Energy of Idaho, Inc. (Renewable Energy) dated February 12, 2004.

Renewable Energy proposes to design, construct, install, own, operate and maintain a 17.5 megawatt (MW) biomass (primarily wood waste) generating facility to be located at the old Boise Cascade Plant site near Emmett, Idaho (the Project). The Project will be a qualified small

power production facility (QF) under the Public Utilities Regulatory Policies Act of 1978 (PURPA).

Under the terms of the Agreement, Renewable Energy has elected to contract with Idaho Power for a 20-year term. The Agreement contains non-levelized published avoided cost rates as currently established by the Commission for energy less than 10 MW and a negotiated price for energy over 10 MW.

The Agreement also contains terms similar to those contained in contracts recently approved by the Commission. Many QF facilities, due to less than 100% capacity factors and unknown incremental fuel supplies, the Company contends, are not able to commit to a long-term firm commitment of the incremental energy production above 10 MW. To address this issue, Idaho Power has developed a concept of "Optional Energy." Optional Energy is all energy that the Project delivers to Idaho Power that exceeds 10,000-kilowatt hours in a single hour, typically non-firm energy, as defined in ¶ 1.18 of the Agreement. Optional Energy is identified through hourly metering. The price for this energy has been negotiated between Idaho Power and the Project. As non-firm energy, Idaho Power considers the value of this energy to be a variable current month market based price.

Renewable Energy requested that fixed prices for its Optional Energy be established rather than receiving the monthly variable market prices. Idaho Power and Renewable Energy, therefore, negotiated fixed prices for the Optional Energy (Section 7.5 of the Agreement) in consideration of the Project providing year-ahead firm commitments of the monthly Optional Energy amounts (Section 6.4 of the Agreement). The concept of Optional Energy, the Company contends, maintains the integrity of the 10 MW limitation and the QF published avoided cost rates but also allows the project developer the ability to assess its specific facility's performance, capital cost and other risk/benefit factors in designing the size of the QF's individual facilities.

Also applying to this Optional Energy, are Company-developed Shortfall and Surplus Energy concepts (Sections 7.7 and 7.8 of the Agreement), as previously included in the Company's Tiber Montana LLC contract approved by the Commission in Order No. 29232 and the recently submitted Agreement with United Materials of Great Falls, Inc. (Case No. IPC-E-04-1).

ANALYSIS

Commission-Approved Methodology for Rates for Projects Larger Than 10 MW

Staff opposes approval of this Agreement because the rates contained in the Agreement have not been determined in accordance with the approved Commission methodology for projects 10 MW and larger. In Case No. IPC-E-95-9, a Settlement Stipulation was approved by the Commission and included as part of its final Order. See Order No. 26576 and the Settlement Stipulation included as Attachment No. 1. The Settlement Stipulation describes in detail how avoided cost rates are to be determined for projects 1 MW and larger. In later Order Nos. 29029 and 29069, the Commission raised the threshold for published avoided cost rates from 1 MW to 10 MW; therefore, since then Staff has assumed that the methodology described in the Settlement Stipulation is to be used for all projects 10 MW and larger.

Although the Settlement Stipulation is now binding upon all parties, it was signed by Idaho Power and most other parties in Case No. IPC-E-95-9, thus indicating Idaho Power's endorsement of the methodology. In fact, Case No. IPC-E-95-9 was initiated by Idaho Power's own application for an Integrated Resource Plan (IRP)-based methodology to be used as a new basis for avoided cost rate negotiations with QFs larger than 1 MW. Staff's recollection is that Idaho Power's own staff was more instrumental than any other party in developing the details of the methodology.

Basically the IRP-based methodology requires that the utility make two runs of its power supply model – one using assumptions consistent with its most recent IRP, and a second with the proposed QF included as a no-cost resource. The difference in net power supply costs computed by the model over the term of the proposed contract represents the value of the QF to the utility and is supposed to serve as the basis for establishing an avoided cost rate for the proposed QF. The methodology is intended to capture and fairly value the different individual generation characteristics of proposed projects.

Since the methodology was adopted, it has only been utilized once to establish a rate for a project larger than 10 MW because only one contract larger than 10 MW has been sought by a project owner in the interim. In Case AVU-E-02-08, Potlatch and Avista negotiated an agreement with rates based on the methodology for Potlatch's 60 MW QF. Avista used the AURORA model, the same model Idaho Power uses for various purposes including its current rate case and its upcoming 2004 IRP.

In production requests, Staff asked Idaho Power to use the IRP-based methodology as prescribed in the Settlement Stipulation to compute rates for the Renewable Energy of Idaho contract. In its response, the Company stated:

By way of background, it should be noted that the Commission accepted the above-referenced Settlement Stipulation in Order No. 26576 dated September 4, 1996. It is important to remember that the length of contracts for QF projects at issue in Order 26576 was limited to five years. Under that condition, the use of forecasting models to set avoided cost rates did not present much risk of overpayment or underpayment.

In the same order accepting the settlement Stipulation, the Commission also reduced maximum contract lengths from 20 years to five years. Staff maintains, however, that the Settlement Stipulation was developed and signed when contract length was still 20 years, and that the methodology in the Stipulation was clearly designed to be used for long-term, rather than short-term contracts (e.g., 20-year rather than 5-year contracts). Staff believes this was the expectation of other parties in the case as well, since there are other, much better methods for establishing rates for short-term contracts. Market data are readily available for short-term contracts. For long-term contracts, such data are not available; therefore, IRPs were used as the basis for establishing rates because their 20-year planning horizon corresponded to the maximum contract length available at the time.

Idaho Power's statement about the use of forecasting models to set avoided cost rates not presenting much risk of overpayment or underpayment if contracts were limited to five years is very misleading. When the methodology was developed by parties in the case, the assumption was that maximum contract length would remain at 20 years. The IRP-based methodology was chosen specifically because the parties felt that it more accurately reflected the value of a large QF to the utility and was more appropriate than the SAR-based method for large projects and long-term contracts. The risk of overpayment or underpayment was believed to be less under the IRP-based methodology, especially for long-term contracts.

In its response, Idaho Power also states, "Order No. 26576 also was predicated on the discontinuance of the use of a surrogate avoided resource in setting avoided cost rates." Staff contends that this statement is simply not true. To Staff's knowledge, the Commission has never considered discontinuing the use of a surrogate avoided resource in setting avoided cost rates.

Idaho Power also states that there are other material differences between the situation that existed at the time Order No. 26576 was issued in 1996 and the situation that exists today. The

Company does not identify any of those differences, however. The Company concluded “the process described in the referenced Settlement Stipulation is not a valid method for setting 20-year avoided costs for QF projects and [the Company] did not use forecast models to negotiate rates with Renewable Energy.”

Staff also asked Idaho Power specifically to compute rates using AURORA, the power supply model the Company is currently using for various types of analysis. The Company responded that

“Idaho Power does not have the forecast model upon which the methodology described in the above-referenced Stipulation was based and the AURORA model will not calculate avoided costs for a 20-year contract. In addition, the AURORA model is currently being extensively updated for use in the 2004 IRP and is simply not available to perform the requested analysis in the near future.”

Staff contends that no particular model was specified when the Settlement Stipulation was adopted. Various models are available and capable of performing the necessary computations. In fact, for the recently approved Potlatch QF contract, Avista used AURORA in accordance with the methodology described in the Settlement Stipulation. Because Idaho Power has AURORA, has used it in the past, has used it in its ongoing rate case, and is using it for its upcoming 2004 IRP, Staff sees no acceptable reason why it cannot be used in this case.

Idaho Power’s Method for Establishing Prices in This Contract

Rather than following the methodology prescribed in the Settlement Stipulation, Idaho Power offered the non-levelized published avoided cost rate for the first 10 MW and offered an Optional Energy Rate for generation above 10 MW. Idaho Power established three criteria to judge the reasonableness of the negotiated Optional Base Energy price.

- 1) The Optional Base Energy Price must be less than the current non-levelized published avoided cost;
- 2) The Optional Base Energy Price must not exceed forward price curves for Idaho Power system border prices for the years that a forward price curve is available; and
- 3) The Optional Base Energy Price must not exceed recent Commission-approved Idaho Power energy purchase prices. The PPL Montana energy purchase agreement was recently approved by the Commission and was used for this comparison.

In order to evaluate the negotiated Optional Base Energy Price against these three criteria, equivalent energy products and prices had to be established to provide like-kind comparisons.

- 1) Comparable Border Market price: An Idaho Power system border forward price curve current at the time of negotiations (January 5, 2004) was used as the initial data. An annual weighted average of the monthly weighted average of the actual Heavy and Light Load Hour pricing was calculated.
- 2) Comparable recent alternative: The PPL Montana purchase power agreement was recently approved by the Commission. This transaction is for only Heavy Load Hours during the months of June, July and August through 2009.

To create a comparable product, it was assumed that the Renewable Energy project would deliver flat 7 MW of Optional Base Energy for the same three months (June, July and August). During Heavy Load Hours, the PPL Montana price was applied and, during Light Load Hours, the estimated Idaho Power border price was applied to create a weighted average price for the entire three months of energy deliveries.

The seasonalized prices from the Renewable Energy agreement for the same months was applied to the same flat 7 MW of generation to produce a comparable weighted average price for the same three months of energy deliveries.

Once the comparable products and prices were established, Idaho Power negotiated a price that met the three initial criteria. Seasonality was applied to the negotiated price in the same manner as it is applied to the non-levelized published avoided cost. An annual escalation factor of 1 % was negotiated for the Optional Base Energy prices. This compares to an annual escalation rate of approximately 2.3% for the non-levelized published avoided costs approved by the Commission.

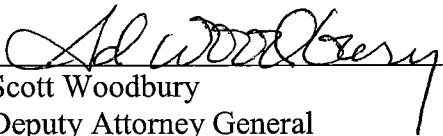
The contract prices developed by Idaho Power are not necessarily unreasonable, nor are the criteria used to judge their reasonableness. The fact remains, however, that Idaho Power failed to follow Commission orders in developing an avoided cost rate. It is presumptuous, to say the least, for Idaho Power to dismiss the Commission-approved methodology as no longer valid without even making an attempt to compute rates in accordance with the methodology. If

rates had been computed in accordance with the methodology then judged unreasonable, Staff might agree that an alternate method was warranted. That was not the case here, however.

RECOMMENDATION

Because Idaho Power has failed to follow the Commission's Orders regarding how avoided cost rates are to be determined for QFs 10 MW and larger, and has instead negotiated a rate based on comparisons to forward market prices and recent Idaho Power contract purchases, Staff recommends that the submitted Agreement be disapproved. Staff recommends that Idaho Power be directed to compute an avoided cost rate in accordance with the prescribed methodology, resume contract negotiations with Renewable Energy, and submit a revised agreement for Commission consideration.

Respectively submitted this 6th day of April 2004.



Scott Woodbury
Deputy Attorney General

Technical Staff: Rick Sterling

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 6TH DAY OF APRIL 2004, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. IPC-E-04-05, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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