

DECISION MEMORANDUM

**TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL**

FROM: SCOTT WOODBURY

DATE: APRIL 19, 2007

**SUBJECT: CASE NO. IPC-E-07-04 (Idaho Power)
PETITION TO REVISE PUBLISHED AVOIDED COST RATES
(A) TO INCLUDE A DAILY LOAD SHAPE
(B) TO CLARIFY RULES REGARDING PUBLISHED RATE
ELIGIBILITY -- DISAGGREGATION**

On February 6, 2007, Idaho Power Company (Idaho Power; Company) filed a Petition with the Idaho Public Utilities Commission (Commission) requesting authority to revise its published avoided cost rates for qualifying facilities (QFs) under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) to reflect Idaho Power's daily load shape and recognize the difference in value between energy delivered by QFs during heavy load hours (HLH) and energy delivered during light load hours (LLH). As reflected in the Company's Petition, this revision would not change the computation of avoided cost but it could change the total revenues received by QFs depending on when during the day they deliver energy.

The Company in its Petition also seeks to clarify the rules governing the entitlement to published rates to prevent QF projects capable of delivering more than 10 aMW per month from artificially restructuring into smaller projects in order to qualify for the published avoided cost rates.

Daily Load Shape Adjustment

Idaho Power reports that since the early 1980s, when PURPA was first implemented in Idaho, the Commission shaped Idaho Power's QF purchase rates to address the difference in

energy values between the various seasons of the year. The seasonalization of the avoided cost rates recognizes that energy delivered by QFs has different values based on when it is delivered.

Similar to seasonalization, Idaho Power contends that energy provided by QFs has different values based on how it can help meet the Company's daily peaks in load. This difference in value between heavy load hours and light load hours, the Company states, was the basis for the daily shape adjustment that was approved for Avista Corporation in Commission Order No. 30111 issued in Case No. AVU-E-06-04. The Company's proposed changes to the published rates to reflect the daily shape adjustment are reflected in Attachment 1 to its Petition.

Disaggregation of Large QFs Into Smaller Projects

Addressing its concern that QF projects capable of generating more than 10 aMW per month will choose to create multiple legal entities to reconfigure themselves into multiple smaller projects in order to qualify for the historically higher published rates, Idaho Power proposes to clarify its rules for published rate eligibility to preclude disaggregation.

Idaho Power states that the disaggregation issue was recently addressed in the PURPA avoided cost rate proceedings before the Public Utility Commission of Oregon (Docket No. UM-1129). The parties to that proceeding, the Company states, settled the disaggregation issue by negotiating a stipulation which was approved by the parties and presented to the Oregon PUC for approval. The stipulation was signed by all of the utilities, the Oregon Department of Energy, the Staff of the Oregon Public Utility Commission, Sherman County and the J.R. Simplot Company. No party to that case, the Company states, opposed the stipulation. In Order No. 06-538 and Order No. 06-586, the Oregon PUC approved the settlement stipulation that defined those small cogeneration facilities or small power production facilities eligible to receive Oregon "standard rates." Idaho Power submits a proposed rule set forth in Petition Attachment 2 proposing language similar to that approved in Oregon.

On February 16, 2007, the Commission issued a Notice of Petition and Modified Procedure in Case No. IPC-E-07-04. The deadline for filing written comments was March 23, 2007. Comments were filed by PacifiCorp dba Rocky Mountain Power, U.S. Geothermal, Inc. and Commission Staff. On April 9, 2007, Idaho Power filed reply comments. The comments can be summarized as follows:

Rocky Mountain Power

Rocky Mountain Power (RMP) supports Idaho Power's Petition and notes its intention to seek approval of similar changes in the near future. RMP requests that the Commission acknowledge in its Order that the type of changes proposed by Idaho Power are applicable to all Commission regulated electric utilities. RMP agrees with Idaho Power that energy has a different value based on seasonal and time of day deliveries. Failing to recognize this difference, it states, could result in either under or over-payment for the value of the power.

Although agreeing with Idaho Power's method of calculating the on-peak/off-peak differential, RMP notes that due to geographic differences among utilities it may be appropriate to use different market hubs or combination of market hubs.

U.S. Geothermal

The comments of U.S. Geothermal (USG) address the complexities, costs and unintended adverse outcomes of the proposed changes. The remedies proposed by Idaho Power, for what the Company perceives to be inadequacies in the existing QF program, USG states, are contrary to existing law, clumsy, unnecessarily broad, mistargeted, likely to result in significant and unintended outcomes, and are wholly inappropriate. The risks inherent in the Company's proposal, it contends, are likely to produce outcomes exactly opposite of the intended results. Many of the potential outcomes would result in costs and inefficiencies, without corresponding benefits, contrary to the interest of the state and its electrical customers.

USG makes the following recommendations, which it states address the Idaho Power stated concerns, without creating costs and outcomes, which do not serve the public interest:

1. Standard form power sales agreements for QF projects meeting the Commission's requirements shall include a representation and covenant by the QF that "the project is a base load facility and will be continuously operated as a base load facility throughout the term of the contract." If the Company feels that a QF is operated in a manner inconsistent with the representation, it could declare a breach and seek appropriate contractual and legal remedies.
2. The Company should be directed to pursue, through actions similar to its filing of Case No. IPC-E-07-03, the remedies for which it believes are QF rate inequities through appropriate QF rate filings with the Commission.

U.S. Geothermal notes that the Idaho State Legislature with its recent adoption of the 2007 Idaho Energy Plan (Plan) specifically cites the importance of developing in-state renewable

energy projects to provide a “secure, reliable energy system by reducing dependence on remote resources,” and to “provide fuel diversity, reducing Idaho’s exposure to high and fluctuating natural gas, oil and coal prices.” In addition, the Plan recognizes that “in-state renewable resources contribute to economic growth by creating jobs and tax revenue in Idaho, frequently in rural areas that are most in need of economic stimulus.” USG contends that the changes proposed by Idaho Power will increase the complexity and cost of QF projects, and will apply an arbitrary, restrictive limit on the location of QF projects, contrary to the 2007 Idaho Energy Plan and the expressed will of the Legislature.

Finally, USG notes that the changes resulting from the Oregon case cited by Idaho Power were only accomplished through the acquiescence of all parties. U.S. Geothermal strongly disagrees with the Company’s proposed changes and recommends that the Commission dismiss them in their entirety.

Daily Load Shape Adjustment

USG contends that the costs required to meet Idaho Power’s daily load shape adjustment proposal, as well as the risks created, will not be offset by any resulting benefits, unless a facility under the current rules was intentionally operated in other than a base load manner, with its output weighted to light load hours. It is just as likely, perhaps more likely, USG contends, that an inaccurate valuation of period prices will result in higher costs to electrical customers than a QF program based on compliance with base load operations. Adverse behavior aimed at maximizing revenues, USG contends, is actually more likely to occur under Idaho Power’s proposal than it is under the current rate structure. In addition, USG contends that the proposal will most adversely impact the smaller qualifying facilities, QFs that are of the least concern to the Company and who could least afford the administrative burdens and direct costs.

USG contends that a more direct approach would appear to be a contractual representation by the QF “that it is a base load facility and will be continuously operated during the terms of the contract as a base load facility.”

(A) Setting Heavy Load and Light Load Values:

Idaho Power in its proposal has utilized the average Mid Columbia heavy load and light load transactions for the period January 1, 2003 through January 20, 2007. The appropriateness of that period in establishing values, USG contends, is unsubstantiated and many questions are left unanswered. Does this approach adequately represent “Idaho Power’s daily

load shape” over the anticipated contract period? Why not a shorter or longer period of historical transactions? Why not a forecasted heavy load and light load price differential for future years? Does the approach adequately reflect the difference in heavy load and light load periods during different seasons within the year? Can a non-base load project operate in a manner that is detrimental to the Company’s customers if the values are not reflective of true market costs?

USG contends that the broad and diverse nature of the QFs within Idaho Power’s QF program, has in the past and will in the future, average out any daily period production variances as long as facilities are not allowed to intentionally operate in a non-base load manner. The Company’s proposal, USG contends, is a complex solution, subject to unintended outcomes, which is being targeted at a very narrow issue that can be more effectively addressed through contractual terms and conditions.

(B) Costs of the Proposal:

USG contends that the Company’s proposal will require additional metering, recording, payment processing and administrative management for implementation. USG notes that Idaho Power has provided no cost benefit analysis information. USG recommends that Idaho Power be required to provide the Commission with an implementation plan, including costs for both the utility and the QF, prior to any approval and implementation of the proposal so that a rational analysis of costs and benefits can be obtained.

Disaggregation of Large QFs Into Smaller Projects

As stated in the Company’s Petition, Idaho Power is concerned that “larger wind powered QF projects will choose to create multiple legal entities to reconfigure themselves into multiple smaller projects in order to qualify for the historically higher published rates.” The Company’s solution to this concern is not a discussion of appropriate rates, but the imposition of an arbitrary ownership restriction on projects located within a “five-mile radius.” U.S. Geothermal contends that such a rule would conflict with federal law and have significant impacts on the re-contracting of existing projects, the future development of new projects and on overall industry efficiencies. USG notes that federal regulations provide that adjacent facilities shall be considered a single facility only if they are located within one mile of each other. Reference 18 C.F.R. § 292.204(a)(2).

U.S. Geothermal citing three examples (all hydro projects) contends that the Company’s proposal will also preclude the re-contracting of existing QF projects located within

five miles of each other and having common ownership. The rules proposed by Idaho Power, USG contends, may also significantly impact the development of new QF projects. How does the Company's proposed rule, it queries, serve the public good?

USG further notes that ownership interest over the life of QF facilities may change for a number of reasons: consolidation, foreclosures, corporate market entry or exit, and residual contractual or leasehold rights to mention a few. None of these potential changes, USG notes, has anything to whatsoever to do with the Company's stated purpose in establishing the proposed rule. The ownership transfers may further well be in direct response to the efficiencies that the market will require in order for the industry to be viable on an ongoing basis. The indirect impacts of the Company's proposed rule on the efficiency of the industry could be substantial, and in any case wasteful, USG contends, without producing any material benefits for either the QF or the electrical customers.

Commission Staff

Daily Load Shape Adjustment

Staff recommends that a daily shape adjustment be approved, but that the amount of the adjustment be \$7.28 rather than the \$11.63 proposed by Idaho Power. Idaho Power's proposed amount of \$11.63 per MWh as the daily shape adjustment is based on the weighted difference in value between on-peak and off-peak prices (the "spread"). To calculate this value, Idaho Power accumulated historical daily volumes and prices for all Mid-Columbia firm heavy load hour (HLH) and light load hour (LLH) transactions for January 1, 2003 through January 20, 2007 provided by Dow Jones. Staff believes the amount of the adjustment proposed by Idaho Power is too high. First, Staff does not believe that it is appropriate to compute a weighted spread based on daily trading volumes because daily prices are completely independent of daily volumes. If a non-weighted average spread were computed instead, the adjustment would be \$8.90 per MWh. Second, an examination of the daily price data shows that the daily spreads exceed the \$11.63 proposed by Idaho Power only 23% of the time. This is because the average of the daily spreads is affected by a few days during the year when the difference between heavy and light load hour prices is extreme. Staff proposes that the daily shape adjustment amount be computed as the median of the historic values since January 1, 2003. The median of the historic values is \$7.28. Staff believes that the median value better represents the difference in value between heavy and light load hours because, by definition, exactly half the time the spread is

greater and half the time the spread is less. Furthermore, because the spreads are not symmetric, Staff believes the median is a better representation of the expected spread than either the weighted or the non-weighted average spread. Staff's comments are accompanied by an attachment showing both an exceedance curve and a histogram depicting the frequency of the historical spreads.

Another reason for adopting an adjustment lower than the amount proposed by Idaho Power, Staff contends, is because the Company's proposed adjustment, when combined with the seasonal adjustment already being applied, would create an extremely wide range of prices. For example, for a 20-year levelized contract, the minimum price would be \$41.11 during light load hours in the spring and the maximum price would be \$81.08 in heavy load hours during the summer. This is nearly a two-fold difference in price. Staff believes that the daily shape adjustment, at least initially, should be somewhat conservative.

Staff notes moreover, that the daily shape adjustment recently approved for Avista in Case No. AVU-E-06-04 was only \$5 per MWh. By Staff's and Avista's own admissions, this value was conservative; nevertheless, it is less than half of Idaho Power's proposed adjustment amount.

In comments submitted in the Avista case, Staff expressed several concerns. One of the concerns was that a daily shape adjustment could introduce greater uncertainty in the monthly payments wind generators would receive because many wind generators have no way of accurately knowing how many kilowatt-hours their project will produce in on-peak versus off-peak hours. Another concern raised by Staff was the need for hourly metering capability at all future projects. Staff's final concern was that adoption of a daily shape adjustment introduces additional complexity into an already fairly complex system of avoided cost rates. While those stated concerns are equally valid in this case, Staff still believes the advantages of a daily shape adjustment outweigh the disadvantages. Staff's proposed changes to the published rates to reflect the daily shape adjustment are reflected in Attachment 2 to its comments.

Disaggregation of Large QFs Into Smaller Projects

Staff recommends denial of the Company's proposal to clarify its rules for published rate eligibility to preclude disaggregation. Staff believes that project developers will devise ways to circumvent the proposed rules, making them ineffective in accomplishing their intended objective. In a production request, Staff inquired of Idaho Power about the likely effect on

existing projects if the definition had been in place, since many wind projects are clustered in the same area. The Company responded that it “. . . cannot not say for certain that some existing wind developments might have been precluded from obtaining contracts under the proposed definition.” Idaho Power also went on to say “Of course, if the definition had been in place before the 18 wind Firm Energy Sales Agreements were signed, Idaho Power expects that the wind QFs could have been restructured to avoid any problem with the definition.” Staff believes it would be bad policy to adopt a new rule if there are serious doubts from the beginning about whether it will actually achieve its intended objective.

Idaho Power Reply Comments

Daily Load Shape Adjustment

In response to comments filed regarding the Company’s proposed daily load shape adjustment Idaho Power believes that Staff’s recommended method for computing the heavy load hour/light load hour price differential represents a reasonable and probably better approach in light of the fact that the Company is currently proposing other rate changes to reflect integration costs for wind QFs.

Idaho Power contends that U.S. Geothermal does not understand the rationale underlying the Company’s daily load shape adjustment proposal. The Company’s intent in proposing a HLH/LLH rate differential is not to encourage or discourage base load operation by QFs. The Company’s primary purpose instead is to more accurately value the energy being delivered. It is difficult for the Company to understand how U.S. Geothermal’s alternative proposal, with its remedy for breach of the provision being litigation, presents a less complicated approach. Idaho Power believes that its approach is self-executing and does not require litigation to provide the intended result.

Regarding U.S. Geothermal’s express concern that the rate differential proposed by Idaho Power will give incentives to QFs to modify the way they operate their projects and skew their deliveries to heavy load periods, Idaho Power does not see that as a bad result. However, Idaho Power’s experience over the past 20 years has been that QFs will generate all the energy they can all the time.

Regarding U.S. Geothermal’s concern that heavy load hour/light load hour periods identified today may not reflect the value of energy in future years, Idaho Power concurs that it

would be prudent to periodically review the price differential between and if necessary, adjust the rate differentials to reflect changes in “the spread.”

U.S. Geothermal argues that Idaho Power’s proposal will require additional metering, recording, payment processing and administrative management for implementation and, as a result, QF program costs will increase. Idaho Power contends that U.S. Geothermal is incorrect. Idaho Power currently installs metering and telemetry equipment on all QF projects larger than 1 MW that is capable of recording the times when deliveries of generation occur. Meters with data storage capability can be installed on smaller QF projects that will track when energy is generated and delivered. These data storage meters cost approximately \$500 more than regular meters. The computation of payments to QFs based on the different times of delivery will require a one-time change in the relatively simple spreadsheet program the Company uses to compute payments to QFs. In reality, the Company contends that the incremental cost of implementing and administering the Company’s HLH/LLH proposal is negligible.

Disaggregation of Large QFs Into Smaller Projects

Regarding the Company’s proposal to limit QFs with common ownership from being located closer than five miles of each other, Idaho Power contends that U.S. Geothermal’s assumption that the Company’s proposal is impermissible under federal law is incorrect. Idaho Power states that it is not proposing to change the test for QF status. PURPA’s one-mile radius standard would still apply for the determination of QF status. However, under PURPA, it is the Idaho Commission, not FERC, Idaho Power contends, that determines which projects are entitled to the published rates. The five mile radius test Idaho Power proposes, the Company contends, deals solely with entitlement to published rates and is no way, it states, contrary to federal law.

Regarding Staff’s argument that the five mile radius approach proposed by the Company is desirable in principal but should be rejected because QF project developers will always find ways to circumvent Commission-imposed rules, Idaho Power states that Staff’s reasoning in part misinterprets Idaho Power’s response to a Staff production request. In the production request, Staff inquired about the likely effect on existing projects if Idaho Power’s proposed five-mile radius definition had been in place earlier. The Company responded that because it is not privy to ownership information concerning QF projects, it “cannot say for certain that some existing wind developments might have been precluded from obtaining contracts under the proposed definition.” The Company went on to say however that “of course,

if the definition had been in place before the 18 wind Firm Energy Sales Agreements were signed, Idaho Power expects that the wind QFs could have been restructured to avoid any problem with the definition.” Obviously, Idaho Power states it should have been more clear in its response. Idaho Power’s response was only intended to indicate that if QF developers know what the rules are ahead of time, they can comply with them.

It is not Idaho Power’s intent that its proposed five-mile radius rule place undue burdens on the development of new QF generation projects. At the same time, the Company believes that it is important for the Commission to honor its longstanding policy that it is in the public interest for small QFs to receive the published rates and large QFs to have their avoided costs determined using the IRP methodology. Idaho Power believes that its proposed five-mile radius rule is consistent with the Commission’s policy by requiring each small QF to demonstrate a separation of ownership and control. Idaho Power does not believe that the current policy of setting avoided cost rates based on the size of the QF project is inequitable or inappropriate.

U.S. Geothermal in its comments cites three instances where pairs of relatively large QF hydroelectric projects are located in close proximity to each other. USG contends that application of Idaho Power’s proposed five-mile radius rule make require the application of the IRP methodology to set their avoided cost for a contract renewal. Idaho Power contends that the public good is served by having the avoided cost rates for these large QF projects determined using the more sophisticated and precise IRP methodology. Idaho Power anticipates that when these contracts expire, regardless of what methodology is used to compute avoided costs, the owners of the projects will shop the generation from the projects to the highest bidder. Speculation as to what will happen with these contracts far in the future, Idaho Power contends, is not particularly productive.

Idaho Power maintains that its proposal is prospective and potential QF developers will have ample notice and opportunity to develop their projects in a way that complies with the rule.

COMMISSION DECISION

Idaho Power has proposed to revise its published avoided cost rates to (a) include a daily load shape and (b) to clarify rules regarding disaggregation of large projects to qualify for published avoided cost rates. U.S. Geothermal opposes both proposals. Commission Staff

recommends a different methodology for computing the daily load shape adjustment and Idaho Power concurs in Staff's alternate methodology. Commission Staff opposes the Company's proposed change to rules governing entitlement to published avoided cost rates. Idaho Power maintains that its disaggregation proposal is justified and that the five-mile separation does not run counter to FERC rules. Does the Commission continue to find it reasonable to process the case pursuant to Modified Procedure? Does the Commission find the Company-proposed changes (as modified) to be reasonable?

Scott D. Woodbury

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