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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPROPRIATE DISPOSITION OF PROCEEDS FOR THE SALE OF IDAHO POWER COMPANY'S SO_2 EMISSION ALLOWANCES IN CY 2007.	**CASE NO. IPC-E-07-18** **COMMENTS OF THE COMMISSION STAFF**

On November 9, 2007, Idaho Power Company filed a report disclosing that the Company sold 35,000 sulfur dioxide (SO_2) allowances in calendar year 2007 for a total (less brokerage fees) of $19,642,250. The after-tax amount of the proceeds allocated to Idaho for SO_2 emissions is $11,257,289.[1] Rather than utilizing the proceeds from the SO_2 sales to offset purchased power costs in this year's Power Cost Adjustment (PCA) case, Idaho Power recommended that the Commission explore other possible uses for the SO_2 proceeds. The Company requested that the Commission convene a public workshop for the purpose of allowing interested persons to discuss other possible alternatives.

On December 20, 2007, the Commission issued Order No. 30478 granting the Company's request to convene a public workshop. The public workshop was held on January 15, 2008. The

[1] The total Idaho jurisdictional after-tax amount of the proceeds is $11,257,289. The Idaho jurisdictional after-tax amount reported by Idaho Power in its November 2007 report is $10,131,560, which represents 90% of the proceeds, or the proposed customers' share.

following persons or entities attended the workshop: Idaho Power, the U. S. Department of Energy, the Idaho Energy Education Project, Ridgeline Energy, the Snake River Alliance, Windland, Avista Utilities, the Idaho Conservation League, the Commission Staff, Micron, Dean J. Miller, and the Industrial Customers of Idaho Power (ICIP). Participants at the workshop were unable to reach consensus regarding the disposition of the SO_2 proceeds. Consequently on February 4, 2008, the Commission issued Order No. 30495 seeking further comments.

THE WORKSHOP ALTERNATIVES

Workshop participants generally discussed four possible uses for the SO_2 proceeds. First, as was the case last year, SO_2 proceeds could be included in the annual PCA case this year. If included in the PCA, the amount of the SO_2 revenue would be grossed up to approximately $16.6 million. This amount would offset the PCA deferral account and mitigate any pending increase in the PCA rates this summer.

Second, Idaho Power suggested that SO_2 proceeds could be used to purchase multi-year streams of renewable energy certificates (RECs; "green tags") from the owners of renewable generation facilities that have entered into PURPA contracts with Idaho Power. Order No. 30478 at 3 *citing* Idaho Power's Report/Motion at ¶ 8. Idaho Power suggested that if Congress enacts a renewable portfolio standard (RPS)[2] for electric utilities, Idaho Power will be required to purchase green tags at prices expected to be higher than those existing today. *Id.*

Third, Idaho Power suggested that the SO_2 proceeds could be used to purchase a wind project's developmental rights. Under such an approach, Idaho Power would enter into negotiations or issue a request for proposal (RFP) to purchase a permitted wind generation project. In essence, the Company would be purchasing the wind project with capital contributed by customers. This would result in a reduction in the Company's rate base. *See* Order No. 30478 at 4.

Fourth, the Idaho Energy Education Project suggested that approximately $500,000 could be used to develop and implement classroom education programs about energy efficiency. The remaining balance of the proceeds could be directed to energy efficiency operations or other beneficial uses.

[2] A RPS typically requires that a certain percentage of an electric utility's generating resources be renewable resources (such as wind, solar, biomass, etc.) by a certain year.

STAFF ANALYSIS

Staff audit verified the SO_2 sales transactions were booked accurately. The review included inspection of all contracts, sales terms for allowances sold, vintage of allowances, price per allowance, and brokerage fees. The evaluation also looked at market conditions to test the reasonableness of Idaho Power's decision to sell the allowances when sold. Interest is calculated monthly on the balance and will continue to accrue, increasing the total funds to be disbursed. Consistent with prior treatment, Staff recommends the Commission's order direct the Company to continue to accrue interest on the SO_2 proceeds until the funds are reimbursed or used.

Include Proceeds in the PCA

Staff believes that the proceeds from SO_2 allowance sales should be used to satisfy the greatest need at this time, which in Staff's opinion, is to offset purchased power costs in this year's Power Cost Adjustment (PCA) case. So far, the balance that will have to be recovered in this year's PCA case is the third highest ever, surpassed only in 2000 and 2001 when the extreme run-up in regional electric prices occurred. The extremely high PCA balance is due to a below average water year in 2007 and an inaccurate forecast of power supply costs last spring. The PCA balance as of the end of January 2008 is $111.2 million. The PCA surcharge that is currently in place is designed to recover approximately $30.7 million. Therefore, if the current PCA balance neither increases nor decreases, an additional $80.5 million more than is currently being collected must be collected through a higher PCA surcharge beginning in June 2008. The result could be a PCA surcharge that is more than three times the current surcharge. The current PCA surcharge is 0.2419 cents per kWh and is applied to the energy charge for all metered customers in all classes.

The effect of passing 90 percent of the SO_2 allowances sales proceeds (including the gross-up) through the PCA would be to reduce the surcharge by approximately 0.1248 cents per kWh. According to Idaho Power, the temporary rate reduction would be as follows for each customer class[3]:

Customer Class	Rate Reduction
Industrial	-3.7%
Large Commercial	-2.9%
Small Commercial	-1.6%
Residential	-2.0%
Irrigation	-2.6%

[3] The amount of the temporary rate reduction is based on a total value of the SO_2 benefits of $16,814,806 as of December 2007, which includes a tax benefit of $6,503,461. The percentage rate reductions are reductions from current rates inclusive of the 2007/08 PCA adjustment of 0.2419 cents per kWh.

Given the extremely large PCA balance that will likely need to be recovered this year, Staff believes that reducing the PCA balance presents the greatest need and is the highest value for use of the SO_2 allowances sales proceeds. Returning the proceeds to customers through the PCA provides the greatest immediate benefit to customers. Although other suggested uses of the funds may have merit, Staff does not believe that these particular funds should be used for those purposes at a time when the PCA surcharge is likely to be extremely high.

Purchase of Renewable Energy Certificates

Staff recognizes the possibility that renewable portfolio standards might be implemented in Idaho in the future, either through state or federal legislation. Staff also recognizes that the cost of RECs may be higher and that they may be less readily available in the future.

Nevertheless, Staff does not support using SO_2 sales proceeds to purchase RECs. First, there is currently no requirement for Idaho Power to own RECs and no assurance that such a requirement will exist anytime soon. Second, the future value of RECs is completely unknown. RECs could become more valuable over time as the demand for them increases and availability decreases. On the other hand, RECs could also become less valuable over time if the cost of renewables remains competitive or becomes less than other non-renewable types of generation, and the need to pay a premium for renewables goes away.

If the Commission did decide to allow sales proceeds to be used to acquire RECs, however, Staff would strongly recommend that only RECs from as yet unbuilt projects be considered. Staff contends that purchasing RECs from existing projects would do nothing to cause more renewables projects to be built. Instead, REC sales revenue would likely just be used to enrich existing projects. In addition, if Idaho Power is allowed to purchase RECs with the funds, Staff believes that Idaho Power should be expected to sell them until the need is known and to return any excess revenue to customers in the meantime.

Purchase of Wind Project Development Rights

Staff believes that Idaho Power's suggestion to purchase wind project development rights has merit. We believe that renewable resources must become an increasingly larger part of the Company's portfolio. The cost of renewable projects is likely to increase as the competition for them increases due to renewable portfolio standards in neighboring states and possible restrictions on greenhouse gas emissions from fossil-fueled generation. The short-term options for new generation are becoming limited and other longer-term options such as coal with carbon capture and sequestration, IGCC and nuclear depend on advances in technology and greater clarity in terms of permitting.

However, despite our support of banking a wind project site for future development, Staff does not support using 2007 SO_2 sales proceeds for this purpose. Early acquisition of renewables sites or development rights to projects is something Idaho Power should be doing anyway, without needing incentive to do so from funds available as a result of SO_2 allowance sales. In addition, Staff believes that Idaho Power ownership of renewable projects could possibly result in lower project costs than simply acquiring project output through power purchase agreements as it is now doing. Moreover, Staff believes that all renewables, not just wind, should be considered. Geothermal, in particular, offers some advantages, and biomass may present opportunities as technologies mature and projects become more cost effective.

Energy Efficiency and Renewables Education

One additional recommendation made during the January 15, 2008 workshop was to dedicate at least a portion of the funds to education programs for efficiency and renewables. Although Staff is supportive of energy education programs, we believe that they can be conducted in conjunction with existing programs for energy conservation and demand side management activities.

Conformance with the 2007 Idaho Energy Plan

The 2007 Idaho Energy Plan offers a number of recommendations aimed at increasing investments in energy conservation and in-state renewable resources. As stated in the Plan, "Conservation and renewables diversify the state's resource base, reducing its dependence on imported fossil fuels and providing insurance against increasing fuel prices. Conservation and in-state renewables also contribute to Idaho's economic development by creating local jobs and tax revenues, frequently in rural areas that are most in need of new economic activity." 2007 Idaho Energy Plan at 1.

The Plan includes policies for Idaho's utilities to "acquire reliable, diverse, cost-effective and environmentally sound resource portfolios sufficient to meet their customers' long-term electricity needs" and "to have access to a broad variety of resource options consistent with Idaho's policy objectives, including both renewable and conventional resources." *Id* at 47. In addition, the Plan recommends that when acquiring resources, priority be given to conservation, energy efficiency, demand response, and renewable resources. The Commission and Idaho's utilities must ensure that their policies provide ratepayer and shareholder incentives that are consistent with this priority order. *Id* at 48. More specifically, the Plan calls on the Commission to establish appropriate shareholder incentives for investments in Idaho renewable resources by investor-owned utilities, such as increased return on investments in renewable resources located in Idaho or by allowing shareholders a share of the net societal benefits attributable to a renewable energy purchase. *Id* at 55.

Staff believes that the four workshop suggestions all conform with the policies and priorities as laid out in the 2007 Idaho Energy Plan. In particular, Staff believes that returning the SO_2 allowance proceeds to customers by including them in this year's PCA is consistent with the Plan because it is economical for customers and provides shareholder incentive to generate surplus credits.

90/10 Sharing

Under each of the proposals advanced initially by Idaho Power, 90 percent of the net proceeds are proposed to be used for the benefit of customers and 10 percent of the net proceeds are proposed to be retained as a shareholder benefit. The 90/10 sharing of SO_2 allowance proceeds was first established in a stipulation that was accepted in Case No. IPC-E-05-26 following the Company's first series of SO_2 sales in 2006. In its final Order in that case, the Commission stated,

> Sharing the proceeds, 90% to customers and 10% to shareholders, will sufficiently align the interests of the Company's shareholders and customers, and provide a financial incentive to the Company to maximize any SO_2 allowance sales for the benefit of both shareholder and customer.

Order No. 30041 at 4. As rationale for the 90/10 sharing of SO_2 allowance proceeds, the Commission found that:

> SO_2 allowances are allocated to the Company based on the ownership and operation of its thermal/coal powered plants. Excess allowances are a direct result of many factors associated with the operation of the coal plants including installation of environmental equipment, the geographic location of the plant, the total time the plant is operated, the nature of the coal used to fuel the plant, as well as other factors. The allowances accrue as a direct result of plant operation and ownership in much the same way that energy generated from the plant is used to meet ratepayer demand and generate surplus sales revenue to offset plant-operating costs. To the extent that coal costs, environmental costs, and surplus energy sales increase/decrease these costs/benefits are passed through to the customers. We find it logical that SO_2 allowances pass through in a similar manner. Consequently, we approve and adopt the Stipulation as a reasonable and logical method to both pass on a major portion of the proceeds to customers as well as align shareholder and ratepayer interests in obtaining the best possible price for excess allowance sales.

Order No. 30041 at 4.

Although Staff does not object in this case to maintaining the historic 90/10 sharing of SO_2 allowance proceeds as are other surplus revenues that are passed through the PCA, Staff believes that the 90/10 split should be reexamined if the proceeds are used for other purposes or credit proceeds are derived from other sources. There is a strong possibility that CO_2 will be a regulated greenhouse gas in the future, with a cap and trade system similar to SO_2. From time to time, Idaho Power may have surplus CO_2 allowances that, if sold, could potentially dwarf the amounts being received from the sale of surplus SO_2 allowances. Consequently, disposition of funds from the sale of allowances could become an even bigger issue in the future. To the extent intermittent proceeds are used for purposes other than to offset PCA deferral balances or proceeds become a significant annual revenue stream, then Staff believes the Commission should consider establishing a methodology to maximize sales proceeds and include the revenue in base rates without PCA sharing.

STAFF RECOMMENDATIONS

Staff is pleased that Idaho Power is willing to explore alternative ways to make use of the proceeds from the sale of SO_2 allowances. However, while some of the suggested uses for the proceeds are good, Staff does not believe that this is the proper time or that these are the proper funds to make investments that may or may not prove beneficial.

Staff recommends that the customers' share of SO_2 sales proceeds be passed through the PCA for the current year. Passing the customers' share of funds through the PCA will reduce the current PCA balance and help to soften the impact of what will still likely be a very large surcharge for 2008. Further, Staff recommends that the historic 90/10 split between funds dedicated to customers and funds available to be retained by shareholders be maintained for this case so long as funds are passed through the PCA as surplus revenue, but that the Commission reexamine whether such a sharing should continue if proceeds are used for other purposes.

Staff's recommendations address only the use of proceeds for 2007 sales of allowances. If sales of additional allowances are made in future years, and if circumstances are different, Staff may make different recommendations than those being made today. If the expected PCA balance is projected to be a credit, for example, and if there is more certainty with regard to the cost and necessity for RECs, Staff would be more inclined to consider alternate uses for SO_2 allowance proceeds.

Respectfully submitted this 25th day of February 2008.

Donald L. Howell, II
Deputy Attorney General

Technical Staff: Rick Sterling
Terri Carlock

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 25TH DAY OF FEBRUARY 2008, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF** IN CASE NO. IPC-E-07-18, BY ELECTRONIC MAIL TO THE FOLLOWING:

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