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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-08-21**
OF A SPECIAL CONTRACT TO SUPPLY)
ELECTRICAL POWER TO HOKU) **COMMENTS OF THE**
MATERIALS, INC.) **COMMISSION STAFF**
)

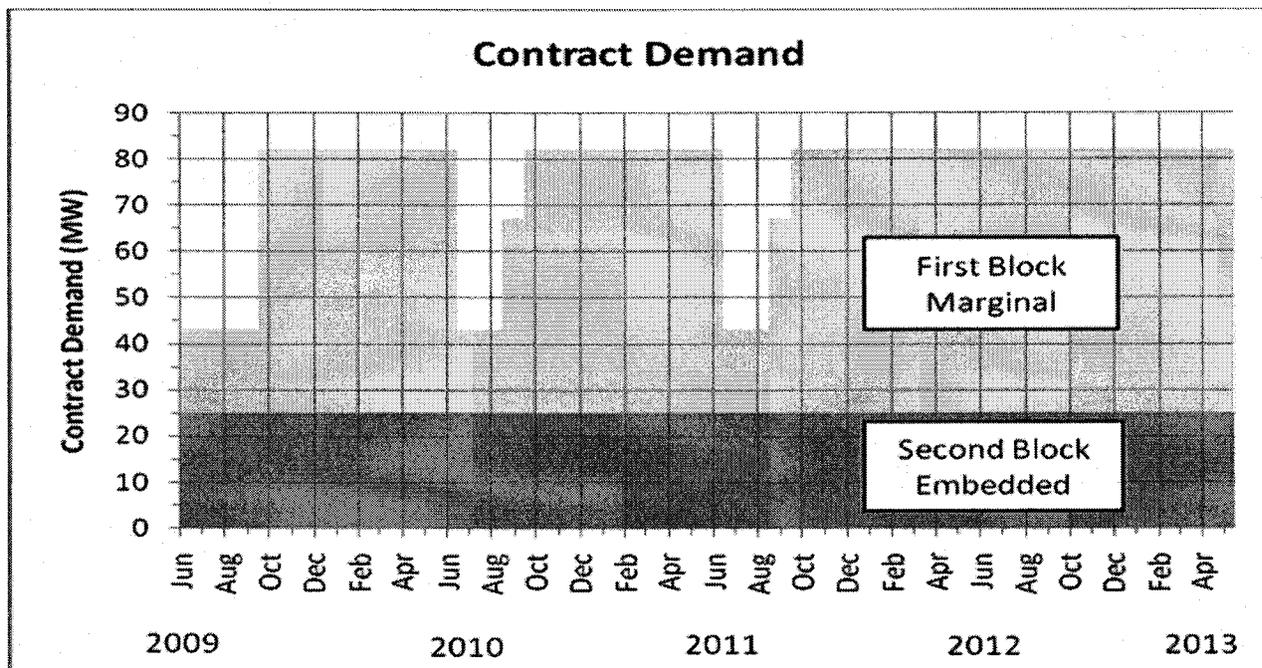
The Staff of the Idaho Public Utilities Commission, by and through its Attorney of Record, Neil Price, Deputy Attorney General, in response to the Notice of Application and Notice of Modified Procedure, issued on December 3, 2008, Order No. 30697, submits the following comments.

BACKGROUND

On October 24, 2008, Idaho Power Company ("Idaho Power" or "Company") filed an Application with the Commission seeking approval of a special contract to supply electrical power to Hoku Materials, Inc. ("Hoku"). Idaho Power and Hoku have entered into an Energy Sales Agreement ("ESA") stipulating that Idaho Power would sell and Hoku would purchase in excess of 25,000 kW. Idaho Power has also agreed to construct, at Hoku's expense, certain interconnection facilities necessary to enable delivery of electrical service to Hoku's facilities. The ESA's effective date is June 1, 2009 and its termination date is May 31, 2013. The total value of the Agreement over its four-year term is approximately \$126.7 million.

Under the terms of the ESA, Hoku's demand will vary during the summer and non-summer seasons. Hoku's peak monthly demand during the term of the ESA will not exceed 82 MW. The parties have agreed that Hoku's scheduled load demand for the summer of 2012 is contingent upon the timely completion of major transmission and generation projects.

The parties have agreed to divide Hoku's demand and energy requirements into two blocks for pricing purposes. The first block demand charge is priced to be reflective of system access costs, which include firm transmission and ancillary services. The first block energy pricing is equivalent to the Company's current Commission-approved avoided cost rates. Two-thirds of the energy in the ESA is first block energy. The second block rates are to be consistent with the Company's approved Schedule 19-T rates. One-third of the energy in the ESA is second block energy. Shown below is a graphical depiction of the first and second blocks and their variation over the term of the Agreement.



STAFF ANALYSIS

First Block Energy Pricing

First block energy pricing is critical because, at the rates contained in the Agreement, first block energy charges comprise over 77 percent of the total value of the contract. One logical way to price first block energy might have been to tie the contract price to some sort of market price index that approximately matches the prices that Idaho Power would be exposed to if it had to purchase power from the market to serve Hoku's first block needs. Such indexes are readily available and frequently used. Index-based pricing would help to insure that the price Hoku is paying to Idaho Power accurately matches the price that Idaho Power is paying to acquire power to serve Hoku. The disadvantage of market-based pricing, however, is that it varies on a daily, or even hourly, basis. Hoku wanted the certainty associated with a fixed price for the term of the contract.

Under the terms of the Agreement, first block energy is priced at a rate equal to the current PURPA avoided cost rate for a levelized four-year contract with a 2009 online date. Idaho Power represents that the decision to use a PURPA rate to price first block energy was made through negotiation of the parties.

Clearly, the Hoku facility is not a PURPA project, nor does it generate any energy that is sold to the utility like other PURPA projects do. Nevertheless, avoided cost rates are intended to represent the costs a utility would incur to generate or acquire additional new energy or capacity.¹ Thus, Staff believes avoided cost rates are a reasonable proxy for establishing a rate to be paid by new customers who place large loads on the utility's system — at least during an initial contract term until the utility is able to acquire long-term resources to serve the load.

The current PURPA avoided cost rate for a levelized four-year contract with a 2009 online date is \$61.66 per MWh. This is the rate that was in effect at the time the Agreement was executed. Any changes to the avoided cost rates that are pending or that occur in the future will not affect the rate contained in this four-year Agreement.

¹ 18 CFR 292.101 (6) *Avoided costs* means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

Second Block Energy Pricing

Under the Agreement, second block energy is priced at Idaho Power's Schedule 19-T rate. Hoku's second block is equal to 25 MW, which is the size limit under Schedule 19. Second block energy rates will be subject to any future changes in Idaho Power's Schedule 19.

Because any other customer with load up to 25 MW would be entitled to Schedule 19 rates, Staff believes that it is reasonable for the first 25 MW of Hoku's load to be priced at Schedule 19 rates as well. Hoku should not be disadvantaged over smaller customers just because of its size. Staff believes that Hoku should be entitled to the benefit of embedded rates for at least some part of its load, even from the beginning of the contract term.

Overall Average Price

One way to assess the reasonableness of the energy prices in the Agreement is to compare them to prices computed using the AURORA model. AURORA is a sophisticated production cost model used by Idaho Power that optimizes dispatch of Company-owned resources, along with all other generation resources in the Western Interconnect, to estimate future electric market prices (among other things). AURORA results are typically used in the Company's general rates cases as the basis for establishing net power supply costs.

For purposes of evaluating energy prices in the ESA, Staff asked Idaho Power to use AURORA to compute marginal energy prices for a four-year future period assuming an addition of load equal to Hoku's expected load. Attachment 1 shows the monthly prices computed by AURORA. Also shown on Attachment 1 are the prices for first block and second block energy. By combining first and second block monthly demand and energy charges, it is possible to derive a single rate per MWh that can be used for purposes of comparison. Note from Attachment 1 that the combined average energy cost for both blocks is sometimes higher and sometimes lower than marginal energy costs computed by AURORA. However, over the four-year term of the contract, the combined average energy cost of both blocks is \$52.69, while the AURORA marginal energy cost is \$55.94. Because the four-year average energy cost is slightly lower than the AURORA marginal energy cost, Staff believes the contract rates are reasonable.

Four-Year Transition to Embedded Rates

The Agreement provides that Hoku is entitled to transition from marginal cost-based rates for its first block energy to embedded cost-based rates at the end of the four-year contract term. As stated previously, first block energy charges make up more than three-fourths of the total charges under ESA.

Hoku's initial proposed maximum load of 82 MW is sizeable in comparison to other individual Idaho Power customers. In fact, once Idaho Power begins providing service, Hoku will be the Company's largest single customer. Obviously, Hoku is not an existing customer. It has not taken service from Idaho Power in the past, nor is it currently taking service. Consequently, Idaho Power's only ability to provide service is through excess capacity and energy it may already have on its system or immediately be able to acquire through off-system purchases. The 82 MW load was not in Idaho Power's IRP at the time Hoku made its request for service or during the time the contract was being negotiated. Consequently, Idaho Power has not procured any new resources in advance specifically to serve Hoku's load.

Although Idaho Power has an obligation to serve Hoku, Staff believes that the Company's obligation to serve very large new loads must be coupled with reasonable expectations about the time needed to acquire new resources and the Company's ability to provide immediate service. Moreover, the price at which Idaho Power provides service is crucial to its obligation in Staff's opinion. At one extreme, Idaho Power could charge Hoku an embedded rate for 100 percent of its load beginning with the first day it provides service, and charge an embedded rate forever. In fact, most new customers are entitled to just such treatment. However, very few new customers, unless they are extremely large, will have a significant impact on Idaho Power's revenue requirement and the Company's ability to continue to serve other existing customers at existing rates. If Hoku were charged embedded rates immediately for its entire load, it is likely that enough upward pressure would be put on rates to cause Idaho Power to seek an increase in all customers' rates through a general rate case. All customers should not have their rates increase just because of a single large new customer. For this reason, Staff does not believe that it would be reasonable to charge Hoku an embedded rate for its entire load from the day Hoku begins taking service.

At the opposite extreme, Idaho Power could charge Hoku a marginal rate forever, based on whatever it costs Idaho Power to procure new supply. Staff believes that this extreme is

equally unreasonable because it would deny Hoku the benefit of lower embedded rates that all other customers are able to enjoy.

Staff believes a reasonable intermediate position is to charge an embedded rate for a portion of Hoku's initial load, charge a marginal rate for the remaining portion of initial load, and transition the marginal portion to an embedded rate over a reasonable period of time. At the end of the transition period, 100 percent of Hoku's load would be at an embedded rate, determined based on cost of service in a manner similar to that used for other special contract customers. This is, in fact, exactly how this Agreement is structured.

The length of such a transition period is a fair question. The four-year transition time period is, by necessity, somewhat subjective. Staff believes it is reasonable, however, for several reasons. First, four years is about the minimum time needed to incorporate the contract into the Company's integrated resource plan and to build any new resources that may be required to serve the increased load. Second, according to Idaho Power, four years is typical of what the Company would ask of a special contract for an initial term. Third, four years commits Hoku to paying a material amount of marginal costs. Finally, four years likely allows for at least one or two rate cases to be processed with Hoku as a customer.

Substation and Interconnection Facilities

The ESA provides that Hoku pay for construction of a substation and transmission upgrade costs under a separate agreement. Under that agreement, Idaho Power retains ownership of the substation and interconnection facilities and pays the associated O&M costs. Because the construction agreement is not a special contract under Idaho Power's rate schedules, the Company is not seeking approval of the construction agreement.

Ratemaking Treatment

For Power Cost Adjustment (PCA) purposes, Idaho Power proposes to treat first block revenues and expenses as if they were wholesale purchases and sales, thereby removing them from PCA treatment. Second block energy - embedded block - would be included as an Idaho retail load and would adjust each year with the PCA. This PCA treatment is similar to the approach authorized when the FMC special contract was served under two blocks, one priced at embedded rates and one at market rates. Staff agrees with the Company's proposed ratemaking treatment.

Other Terms and Conditions

Both the first and second block demand components, as well as the first block of energy, impose take or pay requirements on Hoku. However, Idaho Power has agreed that Hoku may request a release of all or part of its first block energy purchase commitment. Idaho Power states that it will make a commercially reasonable effort to absorb or resell the released energy and provide a credit to Hoku. The amount credited will depend upon the rate period during which the Company receives timely notice of Hoku's request to release its energy demands as well as the Company's ability to manage and supply commitments to serve Hoku's load. Staff believes these terms are reasonable.

Idaho Power acknowledges that its ability to provide all of the power Hoku would like to take during the summer period in 2012 is contingent on timely completion of major transmission and generation projects. If Hoku desires to take additional power during the summer, then Idaho Power is obligated under the ESA to make the same commercially reasonable efforts to obtain proposals to supply Hoku's additional energy request. Hoku will be responsible for the full costs of these purchases and any associated transmission and ancillary service expense to transport such purchase to the Hoku facility. Hoku can expand its first block contract demand up to 175 MW, but its ability to expand is contingent upon the Company's ability to supply and deliver additional power. Staff believes these are also reasonable contract terms, but recommends that the prices and terms of any decision to supply more than 82 MW to Hoku be subject to Commission approval, due mostly to the sheer size and potential cost of such purchases.

RECOMMENDATIONS

Staff recommends approval of the ESA between Idaho Power and Hoku Materials. If Hoku exercises its option under the ESA to increase its contract demand beyond 82 MW and if Idaho Power is able to satisfy Hoku's request to increase its load, then Staff recommends that the price and terms under which such increased load would be served be subject to further Commission approval. Staff also recommends that any future amendments to the ESA be submitted for Commission approval.

Respectfully submitted this 2nd day of February 2009.



Neil Price
Deputy Attorney General

Technical Staff: Rick Sterling

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 2ND DAY OF FEBRUARY 2009, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. IPC-E-08-21, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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SECRETARY

CERTIFICATE OF SERVICE

Average Monthly Energy Cost

