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BEFORE  THE  IDAHO  PUBLIC  UTILITIES  COMMISSION

IN THE MATTER OF THE APPLICATION OF )

IDAHO POWER COMPANY FOR AN ORDER)CASE  NO.  IPC-E-97-9

LIMITING THE LENGTH OF CONTRACTS)

WITH QUALIFYING FACILITIES SMALLER)

THAN 1 MEGAWATT TO FIVE YEARS.)COMMENTS OF THE

)COMMISSION STAFF

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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 Order No. 27000 filed on June 13, 1997, submits the following comments.

On June 5, 1997, Idaho Power Company (Idaho Power; Company) filed an application with the Idaho Public Utilities Commission (Commission) requesting an Order limiting the length of PURPA contracts between Idaho Power and qualifying cogeneration and small power production facilities (QFs) smaller than 1 MW (“small QFs”) to five years or less.

As related by the Company, on September 4, 1996, in Order No. 26576 in Case No.

IPC-E-95-9, the Commission approved a new methodology for avoided cost rate negotiations with QFs 1 MW and larger (“large QFs”).  In its order the Commission found that in light of changes in the electric industry, obligating utilities to 20 year contracts for PURPA power was no longer in the public interest.  The Commission accordingly determined that Idaho Power would not be required to offer contracts to large QFs that are longer than five years until further action was taken by the Commission.

In its present Application, Idaho Power is requesting that the Commission extend the current five year limitation on QF contract length established for large QFs to small QFs.  This request, the Company contends, is consistent with the rationale underlying the limitation on contract length expressed by the Commission in Order No. 26576:

Significant changes have swept through the electric industry since we last examined the issue of contract length.  The FERC has mandated open access to the transmission system, thermal technologies have improved, gas prices are low, there is considerable surplus of energy available in this region resulting in very low spot market prices for electricity and, finally, even the continued existence of PURPA is being called into question.  We find that as the industry as a whole continues to transform to a more free market model, we cannot justify obligating utilities to 20-year contracts for PURPA power.  As the utilities in this case note, such an obligation does not reflect the manner in which they are currently acquiring power to meet new load, [i.e.] through short-term (five years or less) purchases.  Consequently, it would be nothing more than an artificial shelter to the QF industry to provide those projects with contract terms not otherwise available in the free market.  We can find no justification for insisting that Idaho’s investor-owned utilities and their ratepayers assume such an obligation simply to foster one particular segment of an increasingly competitive industry.  We find, therefore, that Idaho’s investor-owner utilities shall not be required to offer contracts to QFs in excess of five years until further action is taken by this Commission.  This ruling, however, does not prevent utilities from offering for approval QF contracts with terms that exceed five years should the utilities believe that such contracts are in the best interests of their ratepayers.

Order No. 26976, pp. 6, 7

INCONSISTENCY IN CONTRACT LENGTHS

Case No. IPC-E-95-9 and Order No. 26976 concerned only contract lengths for QFs one megawatt and larger.  Reduction in contract length was not addressed for small QFs.  Given the position of the Commission as outlined above in Order No. 26576 for large QFs, Staff believes that the same rationale should apply equally to small QFs.  Imposing a maximum contract length of five years for large QFs, while continuing to permit contract lengths of 20 years for small QFs, creates an inconsistency.  Staff believes this inconsistency should be removed.

If the Commission determines that the maximum contract length for small QFs shall be five years, Staff believes that several potential problems with the existing method for calculating rates for small QFs should be pointed out since they are exacerbated by five year, rather than 20-year contracts.  Discussions of these problems follow.

DISCREPANCY IN RATES BETWEEN SMALL AND LARGE QFS

A matter of equal concern to the inconsistency in contract length is the opportunity for discrepancy in rates between small and large QFs.  This discrepancy is the result of using two completely different methods to calculate rates.  Rates for projects smaller than one megawatt are calculated based on the costs of a surrogate, gas-fired, combined cycle combustion turbine.  Rates for projects one megawatt and larger are based on the value of whatever resources are displaced or deferred in the utilities’ integrated resource plans.  In today’s market, the result of this discrepancy is rates for small QFs that exceed rates for large QFs by approximately one-third to one-half.

Because of the substantial discrepancy in rates presently available to small and large QFs, and because small QFs are entitled to much longer contract lengths, there is strong incentive to size projects to be smaller than one megawatt.  This was evidenced recently in the Earth Power cases (Case Nos. IPC-E-96-14, WWP-E-96-6, UPL-E-96-3/UPL-E-96-5) where a conceptual geothermal project totaling six megawatts was designed to be six separate, under one-megawatt projects for purposes of avoided cost rates.  Two different sets of rates and two different minimum contract length requirements invites configuring projects in ways that may not be based on efficient resource utilization or economic equipment sizing.

CURRENT AVOIDED COST METHOD MAY BE INAPPROPRIATE FOR SMALL QFS WITH FIVE YEAR CONTRACTS

If a decision is made to reduce the required minimum contract length for small QFs to five years, then the method currently used to calculate rates may no longer be appropriate.  Under the current method, rates prior to the utility’s first deficit year are based on surplus energy rates, while rates after that time are the sum of the capital, O & M, variable, and fuel costs of a combined cycle combustion turbine.  Exhibit 1 illustrates each of these components for each utility.  Rates are then offered as either fueled or non-fueled, and as either levelized or non-levelized.

If a utility’s first deficit year is several years, or even just a few years into the future, then the rates calculated by the current method are overwhelmingly influenced by surplus energy rates, especially during the first five years.  The influence of the costs of a combined cycle plant are very minor for short term contracts.  In fact, for Washington Water Power, the rates for a five year contract would be based entirely on surplus energy rates, and combined cycle plant costs would have no influence whatsoever.

Surplus energy rates were intended to reflect the rates utilities would have to pay to purchase excess energy available from other utilities.  They have historically been established in lengthy avoided cost proceedings, and are subject to adjustment only at the time of subsequent proceedings.  The surplus energy rates being used in the avoided cost model today, for example, were established in 1995 in Case No. IPC-E-95-9.  Surplus energy rates are, in general, equivalent to what are today frequently referred to as “market rates.”

Most of the complexity of the current avoided cost model is associated with computing combined cycle combustion turbine costs.  The computations associated with rates prior to the utility’s first deficit year are very simple and straightforward.

Determination of a utility’s first deficit year is also becoming somewhat more complicated because of utilities’ increasing reliance on market resources to meet deficits.  In the case of most utilities (Idaho Power and Pacificorp, for example), some market purchases are anticipated almost immediately in order to meet seasonal deficits.  Their IRPs, however, do not plan for acquisitions from major new generating facilities for at least five years.  Consequently, there could be some debate about whether their first deficit year should be set at the year in which capacity must be acquired, even if needed for only a few months, or whether their first deficit year is the year in which their IRPs call for acquisition from a new generating resource.

FIVE YEAR CONTRACTS SHOULD BE BASED ON MARKET RATES

If surplus energy rates are deemed to still be a fair proxy for the value of energy from small QFs prior to a utility’s first deficit year, then Staff believes there are easier and more accurate means of determining these rates.  Energy markets are quickly maturing.  The emergence of a futures market and the abundance of market indexes make determination of the short-term value of energy much easier than before.

One argument made by Idaho Power in support of its application to reduce minimum contract lengths to five years is to minimize its exposure to stranded costs in the future.  This problem could be greatly lessened, or perhaps even eliminated, if rates prior to a utility’s first deficit year are based exclusively on market prices.  Since stranded costs are those costs that exceed the market, then by definition, rates based on market prices cannot cause stranded costs.

CONCLUSION

Staff supports Idaho Power’s application to reduce the required contract length for small QFs to five years, but recommends the Company still be permitted to negotiate longer term contracts if those purchase agreements are judged to be in the best interests of the ratepayers.  It is conceivable that it could be advantageous to lock-in rates for a term longer than five years if it is believed that rates will rise rapidly at some point in the future.

Because the current method for calculating rates for small QFs was conceived with long-term contracts in mind, it incorporates a level of complexity that is unnecessary and magnifies inaccuracies in rates if contract lengths are limited to five years.  If the Commission determines that five years shall be the maximum required contract length for all QFs, then Staff recommends that the Commission consider replacing the current method of calculating small QF rates with a simpler, easier to maintain method.  Alternatively, given the very minimal level of QF development now occurring, the Commission could simply choose to maintain or modify the current method to more accurately reflect surplus/market energy rates and new resource acquisition time frames.  In the event the Commission wishes to change or modify the method, Staff suggests the Commission seek proposals from the utilities, Staff, and other interested parties to devise a suitable alternative.

DATED at Boise, Idaho, this            day of July 1997.

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Scott Woodbury

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