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Attorney for the Commission Staff

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

<b>IN THE MATTER OF A PETITION FILED BY</b>	)	
<b>IDAHO POWER COMPANY FOR APPROVAL</b>	)	<b>CASE NO. IPC-E-03-16</b>
<b>OF MODIFICATIONS TO THE SECURITY</b>	)	<b>AVU-E-03-9</b>
<b>PROVISIONS REQUIRED TO BE INCLUDED</b>	)	<b>PAC-E-03-13</b>
<b>IN AGREEMENTS BETWEEN IDAHO POWER</b>	)	
<b>AND CO-GENERATORS AND SMALL POWER</b>	)	<b>COMMENTS OF THE</b>
<b>PRODUCERS.</b>	)	<b>COMMISSION STAFF</b>

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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 the Notice of Petition, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued on December 5, 2003, submits the following comments.

**BACKGROUND**

On November 5, 2003, Idaho Power Company (Idaho Power; Company) filed a Petition with the Idaho Public Utilities Commission (Commission) for authority to accept modified insurance and lien rights as satisfactory risk mitigation measures in PURPA<sup>1</sup> Power Purchase Agreements that contain levelized avoided cost rates. Without risk mitigation, PURPA Qualifying Facilities (QFs) desiring levelized rates must post liquid funds as security for the

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<sup>1</sup> Public Utility Regulatory Policies Act of 1978, Section 292.

overpayment that results from the front-end loading that occurs with a levelized rate structure. Two of the mitigation methods authorized by the Commission in Case No. U-1006-292 (-292 Case), Order No. 21690 are (1) the purchase of certain basic insurance policies and (2) the establishment of certain lien rights. Attachment No. 1 lists the type of insurance and levels of coverages and deductibles deemed acceptable in Order No. 21690, as amended by Order No. 25240, Case No. IPC-E-93-22. Attachment No. 2 describes the lien rights of Idaho Power on QF projects that receive levelized purchase rates.

In response to the requirements of the insurance industry and either the negligible value of second liens on QF projects or the Company's inability to obtain a second lien on a QF project, Idaho Power proposes to conform its QF contract requirements to contemporary insurance industry standards and realistic lien rights.

Attachment No. 3 shows, in legislative format, Idaho Power's proposed changes to the basic business insurance requirements that are now deemed by the insurance industry to be reasonably available to QFs. The Company proposes that the modified insurance requirements be accepted as basic business insurance coverages for purposes of risk mitigation as established in Order No. 21690, as amended, for future QF agreements and for pre-existing QF projects as their current insurance is renewed.

Due to what the Company contends is the marginal value of the secondary lien position and the inability of the Company, in some circumstances, to obtain security in the form of a second lien, Idaho Power proposes to delete the secondary lien rights as a risk mitigation measure in levelized rate arrangements with QFs. The Company also proposes that the requirement for the establishment of secondary lien rights in favor of Idaho Power as established in Order No. 21690, as amended, for future QF agreements and for pre-existing QF projects as their agreements are amended be rescinded.

## **ANALYSIS**

### **Insurance Requirements**

Idaho Power reports that numerous projects are not now in compliance with the risk mitigation requirements of their specific Power Purchase Agreements with the Company. Some projects carry no insurance while numerous others have insurance products that are standard in the insurance industry but which, in many circumstances, do not conform with the insurance

requirements of the projects' agreements. Idaho Power states that notices were recently sent to the various projects which were non-compliant with respect to the insurance requirements and three common responses were received: (1) the specific insurance required within the Power Purchase Agreement is not currently available from the insurance industry; (2) because the insurance is not available, as a matter of law (i.e., the Doctrine of Impossibility), Idaho Power cannot enforce these requirements or require alternative security; and (3) the financing structures of existing projects do not allow Idaho Power to place a second lien on the project as required in the -292 case.

Regarding insurance, Idaho Power states it has contacted various insurance providers and verified the unavailability of the specified insurance. Staff has also contacted insurance providers for many Idaho QFs and confirms the unavailability or extreme high cost of insurance products specified under current security requirements.

Idaho Power states that some QFs have advanced the Doctrine of Impossibility as a legal defense to enforcement of insurance requirements. Insurance products with the limits and maximum deductibles called for in the current requirements they state are simply no longer offered by the insurance industry.

Staff notes that Idaho courts have held that the Doctrine of "Impossibility" operates to excuse performance. In order to prove Impossibility: (1) a contingency must occur; (2) performance must be impossible, not just more difficult or more expensive; and (3) the non-occurrence of the contingency must be a basic assumption of the agreement. *Kessler v. Tortoise Development, Inc.*, 130 Idaho 105 (1997); *Haessly v. Safeco Title Insurance Company*, 121 Idaho 463 (1992). A *sine qua non* for application of the doctrine is that the parties must have contracted, expressly or in necessary contemplation, with reference to continued existence of the specific thing as a condition essential to performance. *Haessly* at p. 465. Impossibility that is only temporary will not act to discharge a contractual obligation if the contract can yet be performed after the impossibility ceases. *Sutheimer v. Stoltenberg*, 127 Idaho 81 (App.) (1995). Temporary impossibility thereby suspends the duty of performance until impossibility ceases. *Culp v. Tri-County Tractor, Inc.*, 112 Idaho 894 (App.) (1987).

In its -292 security case the Commission in Order No. 21446 made the following statement regarding insurance:

The feasibility of insurance as security against overpayment liability is dependent upon the willingness of the industry to ensure against economic abandonment for a 35-year period with limited rights of cancellation (non-payment of premium). It was the expressed concern of some that insurance companies rarely make an unconditional commitment to cover all amounts of risk; that a residual risk, the risk above policy limits, remains with the policy holder.

Staff recognizes that Idaho Power's proposed changes to the required basic business insurance coverage will provide slightly less security in the event of a default. However, Staff believes that a slightly lower security requirement is better than having numerous projects with no insurance at all because of changing insurance industry standards that make current insurance requirements unattainable or economically impracticable. Current security requirements are ineffective if enforcement and compliance is not reasonably possible.

Staff has reviewed Idaho Power's proposed changes to the insurance requirements and suggests adding some clarifying language. Idaho Power has verbally concurred with Staff's proposed modifications. Staff's proposed insurance requirements are shown in Attachment No. 4.

#### Second Lien

Regarding liens, Idaho Power reports that the financing arrangements of some projects preclude a subsequent lien position by the Company or any other party without the consent of the primary lender. Where such restrictions do not exist, the Company either places a second lien on the project at the time a levelized rate agreement is executed or at the time a project is amended to conform to the risk mitigation requirements of Order No. 21690, as amended. Realistically, however, the Company contends that the value of security obtained by placement of a second lien on a project is tenuous. Either the value of equipment, particularly on less sophisticated projects, is negligible since used or rebuilt equipment is utilized (often non-standard utility equipment, pump motors running in reverse, etc.) or the value of that equipment is highly financed and the financial institution has the first lien on those assets making the value of the second lien marginal. As the project ages and the financing is either paid or at least reduced, the value of the assets depreciate over the same time frame. Thus, the Company contends, were a project to default, the value of the assets remaining for the second lien would be minor due to removal and other costs. Furthermore, the Company states that the value of a project is generally not the actual value of the physical equipment; instead, the marketable and bankable value of a

project is the value of the projected revenues of the energy delivered to Idaho Power under the levelized rate agreement.

In the –292 security requirements case, Order No. 21690, the Commission in its Findings of Fact found:

1. That levelized rates are an incentive to the development of the CSPP industry;
2. That CSPPs receiving levelized avoided cost payments will be overpaid if they substantially reduce generation or if they discontinue generation (i.e., default) prior to the end of their contract term; ...
4. That the burden of said overpayment falls on the ratepayers unless they are reimbursed by the defaulting CSPP; ...
7. That CSPPs may be unable to provide said reimbursement unless they are required to establish and maintain some form of liquid security; ...
10. That it is just and reasonable to require CSPPs to maintain a form of liquid security equal to 100% of the estimated cumulative overpayment (estimate) throughout the life of each QF Power Purchase Agreement;
11. That it is just and reasonable to reduce the amount of the required liquid security (required amount) by 25% of the estimate for each QF protected by adequate **basic business insurance** as described herein;
12. That it is just and reasonable to reduce the required amount by an additional 20% of the estimate for each QF meeting the requirements of subparagraph 11, above, and also providing full **engineering certification** as described herein;
13. That it is just and reasonable to reduce the required amount by an additional 10% of the estimate for each QF meeting the requirements of subparagraph 11, above, and also maintaining a **maintenance escrow** as described herein;
14. That it is just and reasonable to reduce the required amount by an additional 35% of the estimate for each QF meeting the requirements of subparagraphs 11, 12, and 13, above, and also providing the energy purchasing utility with **adequate lien rights** as described herein....

In Order No. 21446 in the –292 case the Commission made the following findings regarding lien rights:

We believe that some form of security and/or risk mitigation is necessary to achieve an optimum level of ratepayer indifference...

The lien rights available to secure ratepayer interest in CSPP projects are usually subordinate to the first lien of the project financier. The value of a second lien position in all the QF property and facilities is the measure of degree of control over the project that it imparts with respect to its continued financing, operations and maintenance. Although it provides no liquid fund for satisfaction of overpayment obligation, we nevertheless recognize it as a valuable tool in safeguarding the interests of the ratepayer. To be acceptable a lien should be subordinate only to the first lien of the project financier and the FERC license, as evidenced by an appropriate policy of Title insurance.

...

In Commission Order No. 21690 the Commission stated:

The value to the utility and the ratepayer of a lien is directly related to the quality of the underlying QF. Hence, the 35% reduction in liquid security requirement for this risk mitigation item shall remain in effect only so long as the QF fulfills all requirements of sections G (Basic Insurance), H (Engineering Certification), I (Maintenance Escrow) and J (Lien Rights).

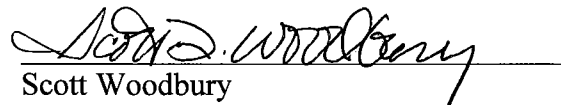
Failure to maintain these terms and conditions at any time during the life of the Power Sales Agreement shall result in the 35% reduction being revoked. Failure to establish and maintain the appropriate new level of liquid overpayment security shall constitute breach of contract.

The risk to Idaho Power if a QF defaults is non-recovery of overpayment liability and replacement of QF power. Overpayment liability is the difference between the levelized rate paid to the QF and the non-levelized rate that would have otherwise been paid. However, because the majority of QF contracts were signed in the 1980s and have levelized rates still far above today's prices, the value to Idaho Power of being relieved of purchasing at high levelized rates may outweigh any accumulated overpayment liability. Ideally in the event of contract default, Idaho Power would be able to recover the QF's overpayment liability and be relieved of further purchases under the contract. Unfortunately, Staff sees no good alternative to second liens as a security measure. Because elimination of the second lien requirement lessens Idaho Power's security position, Staff opposes the Company's request to eliminate it. Staff notes that without a lien, a QF with a levelized contract is required to post as liquid security 35% of the estimated overpayment liability amount. It is the Company's obligation to monitor and maintain appropriate security requirements for its QF contract portfolio in accordance with Commission Orders.

## RECOMMENDATIONS

Staff recommends that the Commission approve the modified insurance requirements for levelized QF contracts as amended by Staff and shown in Attachment No. 4. Staff recommends that Idaho Power's request to eliminate the second lien requirement on QF projects with levelized contracts be denied. To maintain consistency, Staff recommends that any changes approved in this case also apply to Avista and PacifiCorp.

Respectively submitted this 15<sup>th</sup> day of January 2004.

  
Scott Woodbury  
Deputy Attorney General

Technical Staff: Rick Sterling

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# EXHIBIT 1

## INSURANCE

<u>TYPE</u>	<u>LIMITS</u>	<u>MAXIMUM DEDUCTIBLE</u>
Commercial General Liability	<i>The greater of 15% of plant cost or \$1 Million/incident</i>	<i>0.5% of Plant Cost</i>
All Risk Property	<i>Not less than 90% of Plant Cost</i>	<i>0.5% of Plant Cost or \$25,000, whichever is greater</i>
Catastrophic Perils (Earthquake and Flood)	<i>Not less than 60% of equipment cost</i>	<i>5% of Plant Cost</i>
Boiler/Machinery	<i>Not less than 90% of equipment cost</i>	<i>5.0% of equipment cost or \$25,000, whichever is greater</i>
Loss of Income (Business Interruption)	<i>Not less than 75% of estimated daily income; not less than 20% of estimated annual income</i>	<i>30 days of income</i>

All of the above insurance coverages shall be placed with insurance companies with an A.M. Best rating of A- or better.

ATTACHMENT NO. 1



## **EXHIBIT 2**

### **SECOND LIEN RIGHTS**

The project will provide Idaho Power with adequate security interest in the project, including, but not limited to:

1. A Deed Of Trust securing the project real property and improvements;
2. Title Insurance;
3. A contractually stipulated first lien amount, if any;
4. Appropriate U.C.C. security interests in personal property and fixtures; and
5. Assignments for security purposes of all contract rights including the Firm Energy Sales Agreement, water rights, permits, licenses, easement, etc, relating to the project.

The form of the liens will be tailored to the individual projects depending on the first lien financing and other individual characteristics of the project. Idaho Power's lien rights will be subordinated only to the initial long-term financier's lien, if any.

**ATTACHMENT NO. 2**

## INSURANCE

<u>TYPE</u>	<u>LIMITS</u>	<u>MAXIMUM DEDUCTIBLE</u>
Commercial General Liability	<del>The greater of 15% of plant cost or \$1 Million/incident</del>	<del>0.5% of Plant Cost</del> <u>Consistent with current Insurance Industry Utility practices for a similar property</u>
All Risk Property	Not less than <del>90%</del> <u>80%</u> of Plant Cost	<del>0.5% of Plant Cost or \$25,000, whichever is greater</del> <u>Consistent with current insurance Industry Utility practices for a similar property.</u>
Catastrophic Perils (Earthquake and Flood)	Not less than <del>60%</del> <u>80%</u> of equipment cost	<del>5% of Plant Cost</del> <u>Consistent with current Insurance Industry Utility practices for a similar property.</u>
Boiler/Machinery	Not less than <del>90%</del> <u>80%</u> of equipment cost	<del>5.0% of equipment cost or \$25,000, whichever is greater</del> <u>Consistent with current Insurance Utility practices for a similar property.</u>
Loss of Income (Business Interruption)	Not less than 75% of estimated daily income; not less than 20% of estimated annual income	<del>30 days of income</del> <u>Consistent with current Insurance Industry Utility practices for a similar property.</u>

All of the above insurance coverages shall be placed with insurance companies with an A.M Best rating of A- or better.

**ATTACHMENT NO. 3**

## INSURANCE

<u>TYPE</u>	<u>LIMITS</u>	<u>MAXIMUM DEDUCTIBLE</u>
Commercial General Liability	<del>The greater of 15% of plant cost or \$1 Million per occurrence</del>	<del>0.5% of Plant Cost</del> <u>Consistent with current Insurance Industry utility practices for a similar property</u>
All Risk Property	<del>Not less than 90% 80% of Plant Cost the current replacement cost of plant buildings and/or equipment*</del>	<del>0.5% of Plant Cost or \$25,000, whichever is greater</del> <u>Consistent with current insurance Industry utility practices for a similar property.</u>
Catastrophic Perils (Earthquake and Flood)	<del>Not less than 60% 80% of equipment cost the current replacement cost of plant buildings and/or equipment*</del>	<del>5% of Plant Cost</del> <u>Consistent with current Insurance Industry utility practices for a similar property.</u>
Boiler/Machinery	<del>Not less than 90% 80% of equipment cost the current replacement cost of plant buildings and/or equipment*</del>	<del>5.0% of equipment cost or \$25,000, whichever is greater</del> <u>Consistent with current Insurance utility practices for a similar property.</u>
Loss of Income (Business Interruption)	<del>Not less than 20% of estimated annual income</del>	<del>30 days of income</del> <u>Consistent with current Insurance Industry utility practices for a similar property.</u>

\* Replacement shall be with property of like kind, age and quality.

All of the above insurance coverages shall be placed with insurance companies with an A.M Best rating of A- or better.

**ATTACHMENT NO. 4**

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 15TH DAY OF JANUARY 2004, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NOS. IPC-E-03-16, AVU-E-03-9, PAC-E-03-13, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

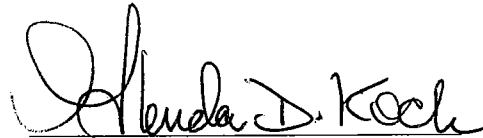
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