Office of the Secretary
Service Date
April 12, 2005

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR AUTHORITY TO INCLUDE IN BASE RATES THE OWNERSHIP AND OPERATING COSTS OF THE REMAINING SHARE OF THE COYOTE SPRINGS 2 GENERATING PLANT AND TO REDUCE THE POWER COST ADJUSTMENT (PCA) SURCHARGE TO OFFSET THE INCREASE IN BASE RATES	)	**CASE NO. AVU-E-05-1** **ORDER NO. 29752**

On January 19, 2005, Avista Corporation filed an Application requesting authority to increase its electric rate base by $62.5 million based upon its recent purchase of Mirant Oregon's half of the Coyote Springs 2 generating plant. Avista calculated that the addition to Idaho rate base[1] would increase the Company's annual revenue requirement in Idaho by approximately 1.89%, or $3.235 million. Rather than increasing its rates, Avista proposed a $3.2 million reduction in the customer PCA surcharge. Consequently, purchase of the plant would result in no net rate change to customers. The proposed reduction in the Power Cost Adjustment (PCA) surcharge would extend recovery of the deferred power cost balance by approximately 12 months to September 2007.

On January 27, 2005, the Commission issued a Notice of Modified Procedure requesting interested persons submit comments no later than March 1, 2005. In response to the Notice, the Commission received timely comments from customers, the Commission Staff, and Potlatch Corporation. Avista filed timely Reply Comments on March 15, 2005. After reviewing the Application and the comments, the Commission approves the Application as described in greater detail below.

THE COYOTE SPRINGS 2 PLANT

Coyote Springs 2 is a 280 MW natural gas-fired, combined-cycle combustion turbine plant located in Morrow County, Oregon. The Coyote Springs site was originally developed by Portland General Electric (PGE) and was designed for two gas-fired units. Coyote Springs 1 was

[1] "Rate base" is the total capital investment in operating plant (less depreciation) upon which a public utility is authorized to earn a return or profit.

completed in 1995 and is owned and operated by PGE. Construction of the adjacent Coyote Springs 2 in January 2001 was in conformance with Avista's 2000 Integrated Resource Plan (IRP). Avista has an operating agreement with PGE for PGE to operate both Coyote Springs units. Application at 11-12.

In 2000-2001, the Company experienced difficulty in securing adequate financing to construct Coyote Springs 2. It subsequently entered into an Agreement with Mirant Corporation to sell half of the Coyote Springs 2 project (140 MW) to Mirant Oregon.[2] In their Agreement, Mirant agreed to pay one-half of the capital costs of building the plant. Avista's cost for its half of Coyote Springs 2 was $108 million. *Id.* at 13; n.11.

Although Coyote Springs 2 was originally scheduled to begin commercial operation in June 2002, operation of the project was delayed until July 2003 "because of the Enron bankruptcy, and problems with the generator step-up transformer." *Id.* at 13 (footnote omitted). After replacement of the transformer, Avista claims that Coyote Springs 2 has operated with a high availability factor of 97.6% and a forced-outage rate of less than 2%. Recent tests conducted in December 2004 also show a favorable heat rate of 6,814 Btu/kWh. To avoid re-occurrence of problems with the step-up transformer, Avista has purchased a spare transformer from a different manufacturer. The spare transformer is now located at the plant and is included in Avista's incremental investment of Coyote Springs 2. *Id.*

THE APPLICATION

A. The Purchase Transaction

In July 2003, Mirant filed for Chapter 11 bankruptcy protection. Mirant and Avista subsequently entered into discussions about Avista purchasing Mirant's half of the plant (140 MW). *Id.* at 14. Avista and Mirant Oregon executed a Letter of Intent and subsequently executed a Purchase and Sales Agreement on October 13, 2004. *Id.*; Exh. L. As set out in greater detail in the Purchase and Sales Agreement, the negotiated purchase price is $62.5 million. According to Avista, the $62.5 million purchase price equates to a cost of $439/kWh of installed capacity (for the 140 MW). This price represents approximately 58% of Mirant's original equivalent cost, i.e., $108 million. *Id.* at 20. To satisfy bankruptcy concerns, the Purchase Agreement also contained a competitive auction provision that allowed other parties to

[2] Mirant Oregon LLC is a subsidiary of Mirant and was the actual half-owner of Coyote Springs 2.

bid for Mirant's half of the project. No other bids were submitted. The Bankruptcy Court approved Avista's $62.5 million bid for the plant on December 15, 2004. *Id.* at 26.

In November 2004, Avista submitted a Section 203 petition to the Federal Energy Regulatory Commission (FERC) requesting permission to transfer the plant from Mirant to Avista. No person commented or intervened in the FERC proceeding. Consequently, FERC approved the transfer from Mirant to Avista on December 30, 2004. On January 20, 2005, Avista assumed ownership of the entire plant. *Id.*

B. Benefits from the Purchase

Avista maintained the purchase of the plant is very advantageous to ratepayers. Avista retained Navigant Consulting to conduct an analysis of the transaction. App. at Exh. K. As part of its analysis, Navigant reviewed other comparable transactions of combined cycle plants and determined that the average value of comparable natural gas plants in the western United States was $569/kW – well in excess of Avista's cost of $439/kW for Mirant's share. Application at 6; Table at 24. Navigant also determined that Avista's purchase price was below the economic value of the plant that was calculated to be approximately $67 million.

Avista asserted the purchase is in compliance with the Company's most recent IRP from April 2003. In its IRP, the Company identified a need to acquire approximately 149 aMW from natural gas-fired, combined-cycle resources. Avista also supplied updated load and resource (L&R) data to support the purchase. Based upon the Company's most recent August/September 2004 L&R data, acquisition of Mirant's share of Coyote Springs 2 mitigates the forecasted supply deficits identified in the first, third, and fourth quarters (Q1, Q3, and Q4) of CYs 2005-2007. *Id.* at 15-19; Exh. H. Thus, acquiring the remaining half of Coyote Springs is consistent with both the Company's 2003 IRP long-term resource strategy and its updated 2004 L&R data. Application at 14-15.

Avista next insisted full ownership of Coyote Springs 2 improves the Company's ability to economically operate the plant. Full ownership allows Avista to now make unilateral dispatching decisions days and months ahead of actual operations. In addition, decisions can be made faster in the event of unexpected plant outages or in the event capital upgrades or repairs are necessary. *Id.* at 21. As of January 20, 2005, Avista asserted that 90% of any margins earned from the recently purchased half will be credited to customers through the annual PCA mechanism.

C. No Net Change in Rates

The Company stated in its Application that it "is not seeking an increase in overall rates presently in effect." Application at 2. Avista maintained that adding the $62.5 million purchase price to rate base would increase its annual base rates by $3.235 million, or 1.89%. To offset this increase, Avista proposes to decrease the present PCA surcharge by $3.182 million or 1.9%. These offsetting adjustments would allow the Company to earn its authorized rate of return of 9.25% (approved in the Company's 2004 rate case, Case No. AVU-E-04-1). Reducing the PCA surcharge would extend recovery of the deferred power costs by about 12 months to September 2007.

THE COMMENTS

A. Public Comments

The public commenters opposed the Company's Application for a number of reasons. Two commenters argued that the purchase of an Oregon generating facility should not result in a rate increase for Idaho customers. Other customers questioned the need for power given the existence of federal and private utility generating resources in the Northwest. Other customers questioned whether a rate increase was necessary and asserted the Company should achieve operating efficiencies through better management of the Company. Finally, three commenters opposed the Application because the offsetting PCA rate adjustment extends the period of the PCA recovery for an additional 12 months.

B. Staff Comments

The Staff recommended that Avista's request to rate base the purchase of Coyote Springs 2 be granted for several reasons. First, the Staff observed that Avista's 2003 IRP identifies seasonal deficiencies beginning in calendar year 2005. The Company identified a preference to purchase an additional 149 aMW of gas-fired, combined cycle generation as part of its blended portfolio. The Staff also noted that in terms of capacity, the Company's updated load and resource data projects monthly deficits to begin in 2006 and such capacity deficits are predicted in 7 out of 12 months by 2008. Staff Comments at 3.

Second, Staff stated that very poor water conditions are projected for this year in the Pacific Northwest. Drought water conditions produce two adverse consequences for Avista. First, the Company produces less generation through its hydroelectric facilities and, consequently, must make more wholesale power purchases. Second, reduced regional hydro flows may result in higher electric prices in the wholesale market. "Under such conditions, Staff believes ownership of the entire Coyote Springs 2 plant will greatly assist Avista in meeting its forecasted load." *Id.* Even if Avista does not need the entire capacity of Coyote Springs 2, the Company's analysis shows that Avista could derive substantial revenue from off-system sales, which would benefit customers in the annual PCA calculations.

Next, the Staff determined that the $62.5 million purchase price for the second half of Coyote Springs 2 is reasonable. Staff asserted the purchase price for the second half of the plant must be evaluated under <u>current and future conditions</u>. *Id.* at 4 (emphasis added). Staff reviewed the financial analyses performed by Avista and Navigant Consulting and concluded that the purchase price was reasonable. *Id.* at 5. Staff also noted that both the Avista and Navigant studies found the purchase price was less than the value of the plant. *Id.* at 4-5.

Finally, Staff audited the Company's calculations and concluded that adding the second half of Coyote Springs 2 to Idaho rate base would result in an increase of $21.642 million. This addition would produce a need for an additional revenue requirement of $3.235 million per year (based on the Company's authorized rate of return of 9.25%). While the Staff was reluctant to prolong recovery of the already booked PCA surcharge balances in the face of another year of potentially poor water conditions, Staff agreed with the Company's rate proposal. Staff noted that "rate stability is important to customers and the Company's proposal achieves this objective, which … offsets the negative aspect of prolonging the [PCA] recovery period." Staff Comments at 7.

C. Potlatch Comments

Potlatch asserted the Company's Application to rate base the second half of the Coyote Springs 2 plant is neither cost effective nor reasonable. Potlatch argued that focusing on the purchase price in relationship to either the Avista and Navigant Consulting studies, or Mirant's initial cost, is misplaced. Instead, Potlatch maintained the relevant question is whether the plant is needed to serve the utility's ratepayers and whether Coyote Springs 2 "is the least cost alternative for meeting any need that does exist." Potlatch Comments at 2.

Potlatch insisted that Avista has had no need for additional generating resources for a number of years. Potlatch points to Avista's 2003 IRP which states that Avista "is in a surplus capacity position through 2009." *Id. citing* Avista 2003 IRP at 7 (April 30, 2003). Although Potlatch acknowledged that the 2003 IRP forecasts that Avista's energy surplus will be eliminated in 2008, Potlatch stated that this forecast is premised on an overly rigorous 80% confidence interval. *Id.* "Under average conditions, the IRP projects annual energy surpluses through 2009 as well." *Id.* at 2. Thus, Potlatch questions the need for Avista acquiring this generating resource.

Potlatch next argued that Avista's analysis of resource deficiencies by calendar quarters is a marked departure from traditional IRP planning based on whole years. *Id.* at 3. Potlatch insisted that Avista's own documents demonstrate that the Coyote Springs 2 acquisition is not cost effective for meeting any quarterly deficit that may occur prior to 2011. In particular, Potlatch points to Avista's Exhibit I, pages 7 and 8 which purportedly shows that the rate impact of the Coyote Springs 2 acquisition will be "negative" until 2011. Moreover, Potlatch insists that the "break even point" (where early rate increases are offset by later cost savings) will not occur until early 2018. *Id.* at 4.

Even if Avista needs additional generating resources, Potlatch argued that Avista has failed to adequately demonstrate that the resource deficiency could not be met with "smaller and less expensive incremental purchases of [demand-side management] DSM, small power production, or other resources." *Id.* Avista's filing does not contain any comparative analysis of the present value of any resources except for gas-fired plants. In other words, instead of looking at the entire range of available resources on a cost-efficient basis, Avista merely focuses on gas-fired plants.

AVISTA REPLY COMMENTS

1. Resource Need. In its Reply Comments Avista takes exception to Potlatch's comments. Avista asserted that Potlatch's argument that Coyote Springs 2 generation is not necessary to serve Avista's customers, is erroneous. Avista argued that Potlatch's "IRP argument" is based upon stale 2003 data, rather than on the "more current information" from 2004. Reply Comments at 4. Avista explained that its 2003 IRP was based on 2002 load and resources (L&R) data. In the present Application, Avista utilized August/September 2004 L&R data. *Id.* The 2004 L&R data shows "an increasing need for resources beginning in 2006 on an annual average energy basis when compared to the 2003 IRP, which was based on 2002 L&R data." *Id.* Avista maintained that Potlatch's reliance on the 2003 IRP "fails to take into account current information" contained in the Company's Application. *Id.* at 5.

Avista also asserted that Potlatch has "misread" Avista's L&R positions. Avista asserted that its quarterly L&R deficiencies "are, in fact, significant and justify the acquisition of the second half of Coyote Springs 2." *Id.* at 6. The Company recognized that its L&R data does not show deficiencies in the second quarter of the year primarily due to hydro generation during the spring runoff period. However, Avista maintained its 2004 data shows that the second half of Coyote Springs 2 will address "significant deficits in Q1, Q3, and Q4." *Id.* at 6 (emphasis original).

Avista next defended its use of the 80% confidence interval for its resource planning. Avista stated that it has used the 80% confidence interval as the appropriate measure to analyze generation and load in both its Idaho and Washington IRPs. Avista observed both state commissions have reviewed and accepted the confidence interval methodology for determining Avista's resource needs. *Id.* at 7. Avista noted that it has not used "average or normal" water conditions for the determination of long-term resource needs in its IRP.

2. Cost Effectiveness and Alternatives. Avista next asserted that Potlatch's argument about the cost effectiveness of acquiring the second half of Coyote Springs 2 is incorrect. Avista used a net present value analysis over the life of the project to calculate the cost effectiveness of the project. Avista maintains that Potlatch's analysis is "fundamentally flawed" because it unreasonably focuses on only a portion of the plant's net present value over the 20-year life of the plant. Avista explained that its net present value analysis was based upon the entire 20-year life of the project. Avista conceded that a capital project will typically have higher front-end costs but will have typically lower costs over the latter portion of its life as the project is depreciated. Reply Comments at 9. "The net present value approach captures the value of project benefits or costs regardless of where they occur throughout the life of the project and appropriately discounts those values to the extent they occur in the future. *Id.* Rather than examining the net present value over the 20-year useful life, Potlatch arbitrarily focuses on the first 13-year period. Avista contended that Potlatch made the same flawed analysis regarding ratepayer costs and savings in evaluating Avista's Exhibit I, pages 7 and 8.

Finally, Avista disputed Potlatch's assertion that less expensive DSM, small power production or other resources might be a more reasonable alternative than purchasing the second half of Coyote Springs 2. Avista calculated that acquiring the second half of Coyote Springs 2 for $62.5 million results in an installed cost per kilowatt of $439. Avista observed that Staff agreed this price is less than the average price for other combined cycle plants in the Pacific Northwest and below the Commission's avoided cost calculation ($736/kW). Reply Comments at 12. Moreover, Avista said it continues to evaluate and acquire cost-effective DSM and other resources. It anticipated acquiring an additional 25 aMW of DSM resources over the next five years. *Id.* at 13. In 2004, Avista acquired 35 MW of wind resource capacity and purchased approximately 7 aMW of small hydro from the City of Spokane. *Id.* Avista also stated that it plans to upgrade several of its hydroelectric facilities over the next seven years which would result in an increase of 26 MW of capacity and 8 aMW of energy. *Id.*

DISCUSSION AND FINDINGS

After having reviewed the Application and the comments submitted in this case, we find it is reasonable and in the public interest for Avista to increase its Idaho electric rate base to reflect the purchase of the remaining half of the Coyote Springs 2 generating facility. As Potlatch suggested in its comments, we begin our analysis by examining whether Avista needs additional resources to serve its ratepayers. Based upon the evidence contained in the record, we find that Avista has adequately demonstrated a need for additional generating resources to meet its projected load. Although Potlatch observed that Avista's 2003 IRP states that Avista "is in a surplus capacity position through 2009," we find Potlatch's reliance on the 2003 IRP is misplaced and ignores more current data. As Avista and the Staff note in their comments, this Application utilizes August/September 2004 load and resource (L&R) data instead of the 2002 L&R data used as the basis for the 2003 IRP. Avista's 2004 data shows an increasing need for generating resources. More specifically, the 2004 data shows that the Company will experience energy deficits in the first, third, and fourth quarters beginning in 2005. The data also shows that additional capacity will be needed in 2006. In other words, Avista's updated information shows that the Company will experience supply deficiency. Thus, we find that Avista has adequately demonstrated a need for additional generating resources.

Having determined that Avista will be resource deficient, our next task is to determine whether the purchase of the remaining half of Coyote Springs 2 is a reasonable response to meet the projected deficiency. Based upon our review of the record, we find there are several reasons why purchase of the remaining half of Coyote Springs is an appropriate response. First, Avista, Navigant Consulting, and the Staff determined that purchase of the plant is reasonable. Avista's purchase cost of $439/kW compares favorably to other natural gas plants in the region and the western United States. Staff also noted that this cost per kilowatt is well below the Commission's avoided cost calculation of $736/kW. The purchase price was also below the plant's value as calculated by Navigant.

Second, we also find that the "net present value" analysis performed by Avista and Navigant over the entire 20-year life of the plant shows a positive benefit to ratepayers. We agree with Avista that the net present value analysis is a reasonable approach for determining the value of a long-lived utility resource. In this case, there is a positive net present value to acquiring the plant over its 20-year life.

Third, Avista's full ownership of Coyote Springs 2 also provides other benefits. More specifically, full ownership allows Avista to make unilateral dispatching decisions based upon its own day-to-day needs. Staff also noted the impending poor water conditions for the Pacific Northwest this year. Purchase of Coyote Springs 2 will significantly shore-up Avista's supply resources if drought conditions persist this year and in the near-term. Finally, given the operating efficiencies of the plant, any off-system sales from Coyote Springs 2 would be credited to customers through the Company's PCA mechanism.

Having found that the purchase and rate basing of Coyote Springs 2 is reasonable and in the public interest, the Commission further finds that it is appropriate for Avista to increase its Idaho electric rate base by $21.642 million. This increase in rate base results in an increase to Avista's annual revenue requirement in base rates of $3.235 million predicated upon its authorized rate of return of 9.25%. See Order No. 29602. Although the Commission is reluctant to extend power purchase costs until 2007, we further find that it is reasonable to decrease the PCA surcharge by $3.2 million. The offsetting reduction in the PCA surcharge results in no net rate change to customers.

CONCLUSIONS OF LAW

The Commission has jurisdiction over Avista Corporation and this Application pursuant to Title 61 of the Idaho Code and specifically *Idaho Code* §§ 61-129, 61-523 and 61-622. The Commission finds that it is reasonable and appropriate for Avista to purchase the second half of Coyote Springs 2 based upon the purchase price of $62.5 million.

The Commission further finds that the purchase transaction will increase Avista's Idaho electric rate base by $21.642 million. Following the purchase, the Commission further finds that the Company's current rates will not provide Avista a fair and reasonable return on its added investment. Allowing the Company to increase its annual base rates and charges by $3.235 million will provide it with the opportunity to earn a fair and reasonable return.

The Commission further finds that it is reasonable and in the public interest for Avista to reduce its PCA rates by a corresponding $3.2 million. Consequently, rate basing of the plant will not result in any net change in Idaho rates. Finally, the tariffs and schedules contained in the Company's Exhibit C adequately reflect the authorized changes in base rates and PCA rates.

ORDER

IT IS HEREBY ORDERED that Avista Corporation's Application to increase its Idaho electric rate base attributable to the purchase of the second half of the Coyote Springs 2 generating plant is approved. Avista may increase its Idaho electric rate base by $21.642 million.

IT IS FURTHER ORDERED that Avista shall increase its base rates by $3.235 million as proposed in its tariffs and schedules accompanying the Application in Exhibit C. The increase in Idaho electric base rates shall be offset by a corresponding decrease of $3.2 million in the Idaho PCA surcharge revenues.

IT IS FURTHER ORDERED that the proposed tariffs and schedules contained in Exhibit C to the Application shall become effective April 15, 2005.

IT IS FURTHER ORDERED that Avista may extend recovery of its deferred PCA power costs.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. AVU-E-05-1 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in this Case No. AVU-E-05-1. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 12th day of April 2005.

PAUL KJELLANDER, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

DENNIS S. HANSEN, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

bls/O:AVUE0501_dh2