

DONALD L. HOWELL, II  
DEPUTY ATTORNEY GENERAL  
IDAHO PUBLIC UTILITIES COMMISSION  
PO BOX 83720  
BOISE, IDAHO 83720-0074  
(208) 334-0312  
IDAHO BAR NO. 3366

RECEIVED   
FILED

2005 MAR -1 PM 4:01

IDAHO PUBLIC  
UTILITIES COMMISSION

Street Address for Express Mail:  
472 W. WASHINGTON  
BOISE, IDAHO 83702-5983

Attorney for the Commission Staff

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

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

**COMES NOW** the Staff of the Idaho Public Utilities Commission, by and through its Attorney of Record, Donald L. Howell II, Deputy Attorney General, and submits the following comments in response to Order No. 29694. As described more fully below, the Staff recommends that Avista's Application to rate base its purchase of Coyote Springs 2 be granted.

**BACKGROUND**

On January 19, 2005, Avista Corporation filed an Application requesting authority to increase its electric rate base by \$62.5 million (\$22.1 million for the Idaho Jurisdiction) based upon its recent purchase of Mirant-Oregon's half of the Coyote Springs 2 (CS2) generating plant. Prior to the purchase, Avista and Mirant-Oregon each owned half of the 280 MW plant. Avista

calculates that the plant addition will increase the Company's annual revenue requirement by approximately 1.89%, or \$3.235 million. Rather than increasing the rates customers pay, Avista proposes a \$3.235 million reduction in the existing PCA surcharge. Consequently, purchase of the plant would result in no net rate change to customers. If approved, the proposed reduction in the PCA surcharge would extend recovery of the deferred power cost balance by approximately 12 months to September 2007. Application at 7.

## STAFF ANALYSIS

### Background

Avista's need for additional base load generation has been well documented, beginning with the 2000 update to its 1997 Integrated Resources Plan (IRP). Exhibit E. In the IRP Update, the Company identified a need for a long-term resource of approximately 300 MW of capacity and energy beginning in 2004. To address the immediate need for new base load generation, Avista released an all-resource public Request for Proposal (RFP) in December of 2000. In 2001 the 280 MW Coyote Springs 2 project was selected as the winning proposal. At the time of the selection, Avista intended to own 100 percent of the CS2 plant. At that time, Staff agreed with Avista that the entire plant was needed to serve load. Ownership of the entire plant was consistent with Avista's system demand documented in the 2000 IRP Update. Moreover, Northwest utilities were in the midst of the extreme price run-up of 2000-2001 and were experiencing the consequences of poor water conditions and forced reliance on market purchases. In their own IRPs, many utilities retreated from planned reliance on market resources and returned instead to plans in which most load could be met with company-owned generation.

In December 2001, the effects of extremely poor water conditions and high market prices in part caused Avista to experience financial difficulties. Because it was unable to obtain sufficient financing for the entire plant, Avista was forced to sell half of the plant to Mirant. Avista clearly did not sell half of the plant because it did not need it; instead, Avista's financial challenges made ownership of the entire plant unfeasible.

After selling half of the plant to Mirant, Avista met its growing load by using the half of CS2 that it still owned and supplementing its generation with several multi-year contract purchases from the regional power market. These multi-year contract purchases have for the most part replaced generation that would have otherwise come from the half of CS2 sold to

Mirant. Several of those multi-year contracts expire in 2006. Meanwhile, Avista's loads have continued to grow.

### **Need for the Second Half of Coyote Springs 2**

Avista's 2003 IRP identifies seasonal deficits beginning in 2005. As spelled out in its 2003 IRP, the preferred resource acquisition strategy for the period 2004-2013 includes an additional 149 aMW of gas-fired combined cycle generation as part of a blended portfolio of wind, coal, and conservation resources. Thus, Avista's acquisition of the 140 MW second half of CS2 is consistent with its 2003 IRP.

The Company's most recent load-resource balance calculations show annual energy and capacity deficits beginning in 2006. However, when examined more closely on a monthly basis, Avista's analysis shows energy deficits in 7 of 12 months in 2005. By 2008, the energy deficits increase to 9 out of 12 months. In terms of capacity, monthly deficits are estimated to begin in 2006. But by 2008, capacity deficits are predicted in 7 of 12 months. See workpapers to Exhibit H.

Under normal water conditions and forecasted gas and electric prices, Avista's analysis predicts that the plant will be used immediately to meet the Company's native load in the first, third, and fourth quarters of this year. Application at 15. In the future, the plant's usage would increase. By 2008 Avista estimates that it would again be deficit most of the year even with the second half of CS2.

If gas or electric prices deviate from the expected norms or if water conditions are abnormal, the immediate need for the plant could increase significantly. Under expected prices and conditions, Staff believes that Avista could meet its load for another year or two without the plant by making relatively small or moderate purchases from the market. However, indications so far are that very poor water conditions may persist this year in much of the Northwest. Under such conditions, Staff believes ownership of the entire CS2 plant will greatly assist Avista in meeting its forecasted load.

In any case, the opportunity to buy the remainder of the plant exists now, and delaying the purchase is not an option. Even if Avista does not need the entire capacity of CS2 now to serve its native load, the Company's analysis shows that Avista could derive substantial revenue from off-system sales.

## **Purchase Price**

As stated in its Application, Avista agreed to a negotiated purchase price of \$62.5 million. This price compares to \$108 million that Avista paid to acquire the identical first half of the plant. The purchase price for the second half of the plant represents only 58 percent of the price paid for the first half. This may give the appearance that Avista either overpaid for the first half or made a very good deal for the second half. However, Staff believes that it is misleading to directly compare the costs between the two halves. In prior proceedings, Staff agreed that the \$108 million price paid for the first half of CS2 was reasonable under the circumstances at the time. The price represented exactly half of the cost of the entire plant, the cost of which was determined for the most part through competitive bidding in the 2000 RFP process. Based on conditions at that time and reasonable expectations about future gas and electric prices, the initial purchase price was lower than other alternatives.

Staff contends that the \$62.5 million price for the second half of the plant now must be evaluated under current and future conditions. The current value of the plant depends upon the cost of today's available alternatives and current expectations of costs and revenues associated with purchase and operation of the plant, not conditions that existed four years ago. Several things have changed that makes the value of the plant significantly less than it was before. One of the primary differences now is that new generation has been added throughout the West. With more plants available to be dispatched, the supply-demand balance has shifted. In addition, gas and electric price forecasts have changed, load forecasts have changed, and the availability of generation equipment is much greater than before.

To determine the reasonable value of the second half of the plant, Avista performed an analysis to compute the expected costs and revenue from the plant based on updated load forecasts and fuel prices. The Company performed two complete studies, one in May and the other in September of 2004. The Company analyzed eight different scenarios in which different assumptions were made regarding natural gas prices, electric prices, and transmission availability. The result of this analysis was a range of project values from \$43.1 to \$116.9 million. Avista's base case, or most expected project value, was \$66.7 million. Staff has reviewed the Company's analysis and believes it is reasonable. The wide range of computed

project values is an illustration of the uncertainty and risk associated with new, gas-fired generation.

In addition to conducting its own analysis, Avista hired Navigant Consulting to develop an independent valuation of the second half of CS2. Navigant estimated the value of the half plant to be \$67.2 million, which is slightly above Avista's estimate. Navigant's range of values was from \$34.1 to \$111.1 million. As an additional check of reasonableness, Navigant compared the purchase price of the CS2 plant to prices paid for other comparable plants recently bought and sold. The comparison shows that the \$439 per kW price for CS2 is less than the average price of \$569 per kW for other plants in the West and less than the average price of \$520 per kW for plants in the remainder of the country. In addition, the \$439 per kW price for CS2 is far below the new construction cost estimates assumed by Staff in its avoided cost calculations, by the Northwest Power and Conservation Council, and by other regional utilities in their IRPs.

Based on the analyses performed by Avista, Navigant Consulting and Staff, Staff concludes that the \$62.5 million purchase price for the second half of CS2 is reasonable.

### **Net Power Supply Costs**

In this filing the Company proposes to include in its Idaho rates the cost of adding the second half of the Coyote Springs 2 CCCT generating station to its resource portfolio. The Company's current base rates were established in the Company's recent rate case (AVU-E-04-1) and became final and effective on December 2, 2004. The current rates include the costs of owning and operating the first half of Coyote Springs 2. For the purpose of these comments, power supply costs are divided into two groups. The first group of costs are referred to as "Power Supply Costs." This group includes all of the costs that are tracked in the Company's Power Cost Adjustment (PCA) mechanism including fuel expense, purchase power expense and offsetting secondary sales revenues. The second group of costs are referred to as "Other Power Supply Costs." In general, these Other Power Supply Costs include return on investment, depreciation expense and taxes (discussed in greater detail below).

In the recent completed rate case, the normalized level of Power Supply Costs was determined using the "Aurora" power supply model. In this filing the Company has re-run that model with no changes except those required to include the second half of Coyote Springs 2 as an Avista-owned resource. The result is a decrease in Avista's annual Power Supply Costs of

approximately \$4.0 million on a total company basis. This result also includes gas transportation, electric wheeling expense and two other smaller expenses shown in the Company's Application. However, increases in the "Other Power Supply Cost" group lead to the net increase in the Company's annual revenue requirement.

The decrease in Power Supply Costs was expected because any new resource that is economically dispatched to meet load, or for sales to other utilities, reduces the Company's variable costs of supplying power. Of course, any new resource also increases the Company's fixed costs. Staff verified the Company's projected Power Supply Costs by running the Aurora model including the second half of Coyote Springs 2.

The Company used the projected power supply costs to estimate the base power supply costs used in calculating the Company's monthly PCA deferrals. The Company's calculations are located in Exhibit M, Page 3. If the Company were to add CS2 without updating the base power supply costs used in the PCA computation, the PCA would incorrectly capture a benefit to customers. This occurs because, as previously discussed, a new resource should reduce normalized Power Supply Costs. If this base cost reduction is not included in the PCA calculation, surcharge deferrals are smaller and rebate deferrals are larger than they should be. The proper matching of the costs and benefits of a new Company-owned resource is achieved when base rates and PCA methodology are updated to reflect the new resource. This is what the Company is proposing to do in this filing and Staff agrees that it is appropriate.

### **Coyote Springs 2 Costs and Accounting Treatment**

Staff's examination of this filing included a review of Exhibits A and B (Pro Forma Results and Proposed Rates, respectively). In Avista's recent rate case, Staff examined in detail the underlying documents supporting the inclusion in rate base of Avista's initial half of CS2, as well as the incremental cost to be included in rates associated with the operation of the plant. At that time, the supporting documents covered the entire Coyote Springs project, both Avista's half and Mirant's half. Staff has examined the calculations supporting the Company's request to include the second half of the CS2 project in rate base and rates and finds them acceptable. The information included in this filing is consistent with Staff's audit findings in the last rate case. The calculations included in Company Exhibit A are acceptable to Staff.

Exhibit A shows the recently authorized and the proposed electric operating results and rate base for Avista's Idaho electric operations, as well as the calculation of the proposed revenue requirement in this filing. This Exhibit shows the impact on Avista's authorized Idaho net operating income and rate base including the power supply operations and the capital investment associated with the addition of the second half of the CS2 project as well as the spare transformer for the plant. Staff has examined this exhibit and has found it to be correct.

The addition of the second half of CS2 increases sales for resale by \$9.5 million, and increases total electric expenses by \$10.2 million. The overall impact to net operating income, after taxes, is a decrease in net operating income of \$0.66 million. Increases in "plant in service" occur in the production and transmission accounts. After accounting for accumulated depreciation and deferred income taxes, the total Idaho rate base increase is \$21.642 million. The additional revenue required, after accounting for the increase in rate base and the decrease in net operating income, is \$3.235 million. This increase in revenue allows the Company to maintain its authorized overall rate of return of 9.25% set in the rate case.

### **Rates**

The Company proposes to increase its Idaho base rates by \$3.235 million per year. As previously discussed, Staff proposes no adjustment to this amount. To offset the increase in base rates, the Company also proposes to decrease PCA rates by the same amount so there is no net change in rates. The Company estimates that its proposal will delay complete recovery of the currently deferred PCA balance for approximately one year, until September 2007. Company Exhibit B shows the proposed increase in base rates and the decrease in the present PCA surcharge rates by class. Staff finds the calculations to be correct and consistent with approved PCA methodology.

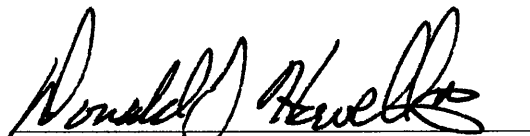
In the face of another year of potentially poor water conditions, the Staff is reluctant to prolong the recovery of already booked PCA surcharge balances. However, Staff agrees with the Company's rate proposal. Rate stability is important to customers and the Company's proposal achieves this objective, which Staff believes, offsets the negative aspects of prolonging the recovery period.

Staff has reviewed the Company's rate calculations and has verified that the tariff sheets filed for Commission approval in this case (a portion of Company Exhibit C) do offset a base rate increase with a PCA rate decrease.

### RECOMMENDATION

Staff recommends that the Company's Application be approved. The Company has requested an effective date of April 15, 2005. The Staff concurs with the proposed effective date.

Respectfully submitted this <sup>1<sup>st</sup></sup> day of March 2005.



Donald L. Howell, II  
Deputy Attorney General

Technical Staff: Kathy Stockton  
Rick Sterling  
Keith Hessing

i:umisc/comments/avue05.1dhksrpskh comments




## CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 1<sup>ST</sup> DAY OF MARCH 2005, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. AVU-E-05-1, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

DAVID J. MEYER  
SR VP AND GENERAL COUNSEL  
AVISTA CORPORATION  
PO BOX 3727  
SPOKANE WA 99220-3727  
E-mail dmeyer@avistacorp.com

KELLY NORWOOD  
VICE PRESIDENT – STATE & FED. REG.  
AVISTA UTILITIES  
PO BOX 3727  
SPOKANE WA 99220-3727  
E-mail Kelly.norwood@avistacorp.com

  
\_\_\_\_\_  
SECRETARY