ROCKY MOUNTAIN POWER
A DIVISION OF PACIFICORP

201 South Main, Suite 2300
Salt Lake City, Utah 84111

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IDAHO PUBLIC UTILITIES COMMISSION

February 18, 2009

VIA OVERNIGHT DELIVERY

Rick Sterling
Idaho Public Service Commission
472 W. Washington Street
P.O. Box 83720
Boise, Idaho 83720-0074
rick.sterling@puc.idaho.gov

RE: Case No. GNR-E-09-1 – Annual Adjustment of Avoided Cost Rates.

Rocky Mountain Power (the "Company") would like to provide you and the Idaho Commission with our comments regarding the draft avoided cost rates for small non-fuel projects less than ten megawatts that you circulated on January 26, 2009. Although the Company agreed with the stipulation's logic for computing and updating capital costs, heat rate, and O&M Costs in the SAR methodology, the Company is concerned that the overall Qualifying Facility ("QF") avoided cost price that the SAR methodology yields is too high. The assumptions underlying the avoided cost prices in the January 26, 2009 draft paper are representative of elevated pricing and bullish economic perceptions in the first half of 2008 and are not representative of costs that reflect the dramatic recessionary environment that is forecast by most experts to be deep and long. The primary, but not sole driver to the high QF avoided costs in the January 26, 2009 draft paper is the result of using the Northwest Planning and Conservation Council's ("NPCC") Draft Fuel Prices for the Sixth Power Plan, December 29, 2008.

The NPCC price forecast includes five different levels to capture a range of possible outcomes (low, medium low, medium, medium-high, and high). When the NPCC price forecast was first used in the SAR methodology, the Commission expressed confidence that the medium forecast had the highest probability of being right (Order No. 29124, pg. 10). Given the rapid pace of decline in global economic conditions in recent months, the Company feels the medium NPCC gas price forecast is, at present, not the most accurate representation of current market conditions. The NPCC Draft Fuel Prices for the Sixth Power Plan states:

> "The low case assumes slow world economic growth which reduces the pressure on energy supplies. It is a future where world supplies of natural gas are made available through aggressive development of LNG capacity, favorable nonconventional supplies and the technologies to develop them, and low world oil prices providing an alternative to natural gas use. The low case would also be consistent with a scenario of more rapid progress in renewable electric generating technologies, thus reducing the demand for natural gas…"

> "The intermediate cases are variations on the medium case that are considered reasonably likely to occur. The medium-high case would contain elements of the high scenario, however, not to the same degree. Similarly, the medium-low case would contain some of the more optimistic factors described for the low case."

There are a number of market "sign posts" that align well with NPPC's description of their low case:

- World economic growth has slowed and reduced pressure on energy supplies.
- There are a number of significant liquefaction projects coming online in 2009 and 2010, with projects in Indonesia, Qatar, Russia, and Yemen expected to contribute nearly 7 BCF/d of new capacity to the global market.
- In 2008, there was more LNG regasification capacity added than in the four prior years combined, with even larger growth expected for 2009.
- Technological advancements in horizontal drilling and hydraulic fracturing have enabled growth in nonconventional natural gas supplies to outpace declines in conventional production and imports.
- Despite OPEC's efforts to cut production, oil prices remain much lower than the recent highs experienced this past summer. As of January 30, 2009, prompt month WTI crude settled below $42 per barrel.

At the time the NPCC medium gas price forecast was first adopted, there was very little liquidity in the forward markets beyond 12 to 18 months, and thus the ability to test which of the NPCC five forecast levels was most reflective of then current market conditions was limited. However, since 2002, the forward markets have become more liquid, and NYMEX now offers physical contracts for Henry Hub through 2021. The figure below shows how the medium, medium-low, and low NPCC price forecasts compare to NYMEX forwards as of market close on January 30, 2008.

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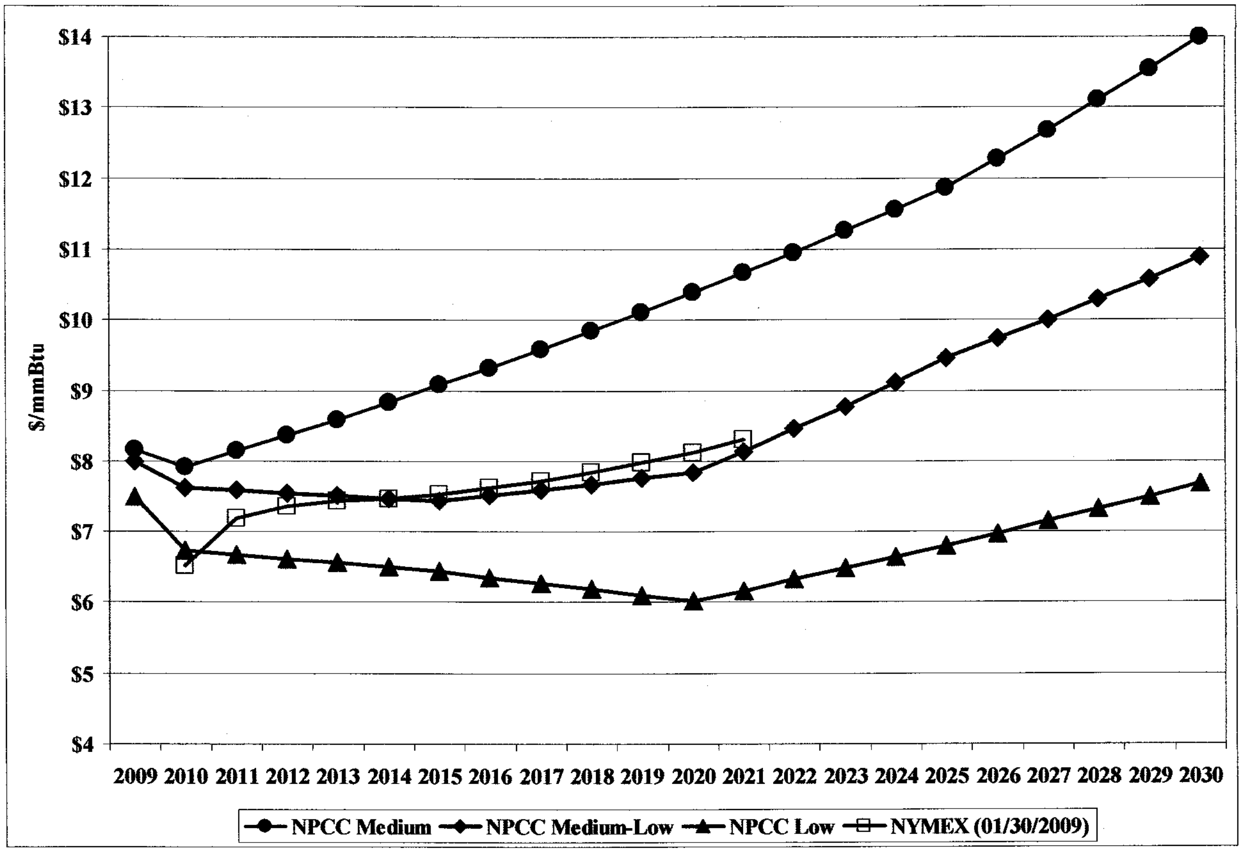
Comparison of Henry Hub Natural Gas Prices (Nominal)[1]



[1]The average NYMEX price from March 2009 through December 2009 is $4.99 per mmBtu. Because this is a partial year average, it is not shown as a comparison against the NPCC forecasts in the figure above. The NPCC forecasts were converted from 2006$ to nominal using a 2% per year escalation rate.

While not shown in the figure above, market forwards for the balance of 2009 are considerably lower than even the low NPCC price forecast. Market forwards in 2010 are most closely aligned with the low NPCC price forecast. Beyond 2010, the medium-low NPCC price forecast begins to align reasonably well with current market forwards. Over the entire NYMEX strip, the NPCC medium case projection is considerably higher than current market. While the Company had previously supported using the median NPCC price forecast, given the NPCC's description of their low case forecasts, current market "sign posts," and current market forwards, the Company strongly believes that the low and medium-low NPCC price forecasts are a better indicator of currant market conditions than the medium case.

According to the methodology circulated on January 26, 2009, the draft avoided cost rate will be a nominal levelized $87.42 per MWh for a twenty year contract for projects on-line in 2009. This rate is 27% higher than current Idaho avoided cost of $68.66 and 15% higher than any avoided cost price Rocky Mountain Power has experienced in other states, where QF avoided cost prices for the same length of contract range from approximately $55 to $74 per MWh nominal levelized. This rate also exceeds those included in the Company's current IRP and that of recently acquired renewable resources. Based on the Revised Protocol agreement, costs associated with new QF contracts which exceed the costs PacifiCorp would have otherwise incurred acquiring comparable resources will be assigned directly to the state approving those contracts. After correcting an error in the draft avoided cost calculation, the revised methodology results in a nominal levelized avoided cost rate of $89.95. The Company is concerned with the impact that establishing an avoided cost of $89.95 per MWh could have on its Idaho customers. The Company's concern is that these extreme rates will become a "magnet" for out-of-state or off-system QF projects seeking the highest prices for their project at a cost to the Company's Idaho customers. To illustrate this point, over the past 5 years, the Company had received a total of a half dozen requests for wind QF projects totaling 100 MW, of which only one resulted in a signed power purchase agreement. Within three days after the January 26th draft methodology and prices were circulated by Staff, the Company received six wind QF project requests, totaling 235 MW. All of these proposed projects are off-system QFs with scheduled deliveries into an already transmission constrained area.

The Company believes that the medium natural gas price curve from NPCC yields a price that is too high, and is not a true reflection of current gas costs. The impact of using the draft medium NPCC fuel curve is approximately two-thirds of the 27% increase in the avoided costs and the Company feels that warrants, at a minimum, postponing Commission approval of the gas curve component until the NPCC fuel prices are final. The Company is also requesting additional time be provided in order to more thoroughly review all of the assumptions used in the NPCC forecast and requests a technical conference be conducted to allow the parties to revisit the existing methodology and come up with a solution in light of the current economic forecasts. Given the dramatic global economic downturn and extraordinary downward impact on commodity costs that has occurred in the last few months, the Company questions the timing of an update that does not appear to reflect current market conditions and suggests the Commission consider updating the price forecast after conditions have become more stable. Accordingly, the Company requests that the Commission reevaluate its use of this draft price curve before QF prices are established using these inflated costs so that Idaho customers are not impacted by potentially above market QF prices.

Please let me know if you have any further questions.

Very Truly Yours,

Jeffrey K. Larsen
Vice President, Regulation
Rocky Mountain Power

Enclosures