

Edl, Michele

From: Rick Sterling [Rick.Sterling@puc.idaho.gov]
Sent: Tuesday, September 30, 2008 11:52 AM
To: Edl, Michele
Subject: FW: Milner power sales agreement?
Attachments: 23529.pdf

From: Rick Sterling
Sent: Thursday, September 18, 2008 7:46 AM
To: 'Edl, Michele'
Subject: RE: Milner power sales agreement?

The Milner Dam power plant is owned and operated by Idaho Power, so there would be no power sales agreement. See the attached Commission Order for more information and for a description of the facility.

-- Rick

From: Edl, Michele [mailto:Michele.Edl@idwr.idaho.gov]
Sent: Wednesday, September 17, 2008 6:26 PM
To: Rick Sterling
Subject: Milner power sales agreement?

Rick,
I have the Milner Dam and Powerplant water right files up for review in my cubicle. I am not seeing a copy of a power sales agreement/contract between the two canal companies and Idaho Power Company. Is there one?
Michele

9/30/2008

JAN 22 1991

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION)
OF IDAHO POWER COMPANY FOR A)
CERTIFICATE OF PUBLIC CONVENIENCE)
AND NECESSITY FOR THE RATE BASING)
OF THE MILNER HYDROELECTRIC)
PROJECT, OR IN THE ALTERNATIVE,)
A DETERMINATION OF EXEMPT STATUS)
FOR THE MILNER HYDROELECTRIC)
PROJECT.)

CASE NO. IPC-E-90-8

ORDER NO. 23529

SUMMARY

This is a Final Order granting Idaho Power Company's ("Idaho Power"; "Company") April 25, 1990, Application for a Certificate of Public Convenience and Necessity for the rebuild of the Milner dam and the construction of hydroelectric facilities at that site. We recognize that, in the ordinary course of events, the Company will be allowed to recover its prudently incurred investment and expenses of the Milner project in its revenue requirement.

On November 27-29, 1990, a formal hearing was conducted concerning the Company's Application. The parties represented at the hearing included: Idaho Power Company; the Commission Staff; Intervenor Industrial Customers of Idaho Power ("ICIP"), and; Intervenor Idaho Consumer Affairs, Inc. ("ICA").

BACKGROUND

On April 25, 1990, the Idaho Power Company ("Company"; "Idaho Power") filed an Application for a Certificate of Public Convenience and Necessity for the ratebasing of the Milner hydroelectric project or, in the alternative, for a determination of exempt status for the project. Since there have never been hydroelectric facilities at the Milner dam site, Idaho Power is required by *Idaho*

Code § 61-526 to obtain a Certificate of Public Convenience and Necessity for the project. This statute provides, in pertinent part:

61-526. Certificate of convenience and necessity.--No . . . electrical corporation . . . shall henceforth begin the construction of a . . . plant . . . without having first obtained from the commission a certificate that the present or future public convenience and necessity requires or will require such construction . . .

Idaho Power has couched its Application in the alternative. That is, it seeks either a Certificate of Public Convenience and Necessity to construct the Milner project and include it in ratebase or a determination by the Commission that the project is exempt from regulation so that the Company may sell the power generated at wholesale rates to outside buyers. The implication of the issuance of a Certificate has become the paramount legal issue in this case.

On August 22, 1990, a prehearing conference was held in both the Milner case and its companion case Swan Falls (Case No. IPC-E-90-2). Following that conference, the parties submitted statements of position on legal and jurisdictional issues. On October 15, 1990, this Commission issued Order No. 23380, in both the Swan Falls and Milner cases, setting forth the following three issues for legal briefing:

1. What is the legal authority for the Commission to approve ratebasing of the Swan Falls rebuild before the rebuild is in service? What is the legal authority for the Commission to approve ratebasing for the Milner project before the project is in service?
2. What is the legal authority or propriety as a matter of policy of using avoided costs as a cap for ratebasing the Swan Falls rebuild? What is the legal authority or propriety as a matter of policy of using avoided costs as a cap for ratebasing the Milner project?
3. Does the Commission have authority to declare in the abstract that a certified plant or a plant by statute exempt from certification may be ratebased without yet knowing the cost of ratebasing the plant and retail

rates? Does the Commission have authority to declare in the abstract that a certified plant or a plant by statute exempt from certification may be excluded from ratebasing for a fixed period in the future without yet knowing the cost of ratebasing and retail rates? How are the rights of utility investors affected in the implied interval created by such a decision?

A formal hearing was conducted in the Milner case beginning on November 27, 1990, and continuing through November 28, 1990. The Swan Falls case was taken up for hearing immediately following Milner and continued through November 29. The parties represented at the Milner hearing included: Idaho Power Company; Industrial Customers of Idaho Power; Idaho Consumer Affairs, Inc.; and the Commission Staff. Afton Energy, Inc. was granted leave to intervene in Milner and Swan Falls on a limited basis but did not participate in the hearing. In addition, all of the remaining parties, with the exception of Idaho Consumer Affairs, Inc., presented evidence through live testimony at the hearing. Virtually all of the witnesses for each party testified in both the Milner and Swan Falls cases.

By and large, Milner and Swan Falls presented identical issues. Those issues tended to revolve around policy and legal matters rather than technical questions of fact. Because of the synonymous nature of the two proceedings, the Commission ruled from the bench, at the outset of the Milner hearing, that it would consider those portions of the transcript for the Milner case that were also relevant to the Swan Falls case so the same cross-examination would not be repeated. See Tr. pp. 294-295, Milner.

IDAHO POWER'S CASE

The Milner project was described by Idaho Power in its Application and through direct testimony as follows:

[1] The facilities will extend 1.3 miles from Milner dam along the existing Twin Falls main canal headworks at Milner reservoir on the Snake River;

[2] Water will be conveyed from these headworks on the south side of the dam through an enlarged Twin Falls canal and directed into a forebay and intake structure, penstock and power houses.

[3] Two power houses, located 1.6 miles downstream from the dam, will use the drop in elevation from the canal to the river bed;

[4] The turbines used will be vertical-shaft, Kaplan-type coupled directly to the generators;

[5] The larger unit will have a rated output of 46,000 kilowatts, a net head of 150 feet, a discharge of 4,000 CFS and a speed of 200 rpm. The smaller unit will have an output of 11,500 kw, net head of 157 feet, discharge of 1,000 CFS and speed of 400 rpm. Tr. pp. 39-44.

In addition to the two large turbines, the Company will construct a power house near the north abutment of Milner dam consisting of a single propeller turbine that will discharge a constant 200 CFS when in operation with a net head of 50 feet. The maximum output will be 770 kw. See Idaho Power Application, pp. 2-3; Tr. pp. 4-9.

Idaho Power also contends that there is an immediate need for the rebuild of the Milner dam itself. The Federal Energy Regulatory Commission's ("FERC") Division of Dam Safety and Inspections has concluded that there is a high risk of failure at the dam in the event of an earthquake. Such failure, the Company contends, would be disastrous to the local farm economy, which relies upon the dam for irrigation. Tr. p. 41.

According to the Company, the dam itself is currently owned by the Twin Falls Canal Company and the Northside Canal Company, Ltd. ("Canal Companies"). Idaho Power states that the Canal Companies initially received a license from the FERC to rebuild the dam and construct a single hydroelectric unit rated at 43,650 kw. Idaho Power was later added as a co-licensee by FERC and the project design was revised as discussed herein. Tr. p. 43. The Company asserts that the timing of the Milner project cannot be deferred.

The Company's estimated cost of rebuilding the dam is \$11,700,000. Idaho Power states that it has agreed with the Canal Companies to provide interim financing to rebuild the dam. The Canal Companies have allegedly agreed to repay this initial loan, with interest, from funds obtained elsewhere at or near the time the plant and dam are completed. The Company will guarantee payment of the complete debt service on this permanent loan through a base royalty equal to the original present value of \$5,638,000 plus one-half the total cost of repairing the dam over the term of the FERC license. Additionally, the Canal Companies will receive an incentive royalty whenever the annual project generation exceeds the base of 142,000 megawatt hours. The Company proposes that if the project is not recognized for revenue requirement purposes by the Commission, the Canal Companies may then exchange the fixed royalty option for 50% of the net benefits derived from off-system sales of the power after the deduction of Idaho Power's costs including a return on equity. Tr. pp. 95-96.

In response to cross-examination by ICIP, Idaho Power witness Lamont Keen stated that the Company's agreement to guarantee payment of debt service on the Canal Companies' permanent financing for dam repairs was to facilitate their obtaining financing under more favorable terms. Keen contends that the

only risk that Idaho Power has in this regard is that the royalty payments Idaho Power agreed to make to the Canal Companies will not equal the amount of debt service, and the Canal Companies fail to cover the balance. Keen perceives this as a "pretty small risk." Tr. pp. 106-107

In its Application, the Company has made a commitment estimate for the total cost of the Milner project of \$60,334,000 at completion in 1992, with dam reconstruction costing an additional \$11,700,000. The Company has included an additional 5% contingency margin for construction of the plant for a total commitment estimate of \$63,350,600. Tr. p. 49. The combined installed turbine capacity will be 58,300 kw.

According to the Company's calculations, the cost per kilowatt hour for the Milner project would range from a maximum of 52.93 mills per kwh based upon total cost of the facilities of \$63,350,600, 60 years of water data and a 50 year levelized cost to 37.80 mills per kwh based upon total facilities cost of \$60,334,000, a cost of capital of 10.85%, twenty years of water data and a 50 year levelized cost. Tr. p. 97. The Company's current avoided cost rates for projects on line in 1992 are:

20 year projects: 52.19 mills kwh
35 year projects: 57.53 mills kwh

Idaho Power has voluntarily agreed to a cap of \$63,350,700 as the maximum amount that may be included in the Company's rate base should the Commission choose to ratebase Milner. However, this commitment estimate could be increased to account for documented changed in escalation rates or scope. In particular, (1) *force majeure* or acts of God, (2) design optimization changes for increasing energy that more than offset the increase in initial investment, and (3) foundation or site conditions significantly more expensive than indicated by the Company's exploratory drilling would be reasons for going above the ceiling.

In cross-examination by Staff, Company witness Baggs was not very receptive to the concept of limiting the value of Milner for rate basing to comparable avoided cost rates. Tr. p. 152

In the event that the Commission chooses not to ratebase Milner, the Company seeks a determination that Milner should have exempt status for revenue requirement and power supply purposes for a period of twenty years to permit Idaho Power to enter into a long-term sale of the energy to another utility. Tr. pp. 49-51.

The Company proposes that two years prior to the expiration of the order determining exempt status, it will apply for a redetermination of the status of the exempted Milner plant. The Commission would, within one year, issue a order either continuing the exempt status or ratebasing the plant. *Id.*

If the Commission chose to ratebase Milner, the Company proposes, it should issue a valuation order within three months. The value of the plant would be based upon the new reproduction cost, less depreciation. *Id.*

In cross-examination, Idaho Power witness Packwood indicated the Company's preference for including Milner in the Company's resource stack as opposed to developing it as an independent power producer. Packwood's rationale is that the Company desires to preserve a unique resource for the benefit of the State of Idaho. The Company, through its alternative proposal of exemption, seeks a mechanism for capturing and preserving Idaho's hydro resources even though they are not currently needed on Idaho Power's system. Tr. pp. 75-79. Packwood would prefer the issuance of a certificate for the present public convenience and necessity. Tr. p. 79.

In cross-examination, Company witness Keen identified two possible methods by which Idaho Power would operate Milner under a Certificate of

Exemption. One would be to place into the hands of a subsidiary for a period of time, and treat it as basically an "unregulated independent power project." Tr. pp. 108-109. The other method would be to treat it as a regulated project by the FERC or, perhaps, the Oregon Commission. Tr. p. 109.

Keen had no objection to the possibility of including Milner in the Company's rate base, but yet allow Idaho Power to sell the power under contract on the open market. Tr. p. 111.

COMMISSION STAFF

The Commission Staff made its own analysis of the estimated cost of the Milner project. Rather than estimating the construction costs of the project, Staff accepted Idaho Power's proposed cap on capital costs of \$63,350,600 as a maximum or worst case cost. From that, Staff estimated the 46 year levelized cost to ratepayers for the Milner project of \$62.73 mills/KWh compared with the comparable estimated cost by the Company of \$52.93 mills/KWh. Tr. p. 300.

The differences between the estimates of Staff and the Company regarding the cost of Milner can be explained as follows. First, Staff did not consider the case of 20 water years as used by Idaho Power in calculating the estimated cost of \$37.80 mills/KWh. Staff's opinion is that 20 water years, while a valuable predictor of the flow immediately following a particular period, is inappropriate for long-term analysis such as determining the value of generation from a resource with a 46 year life. The average of stream flows over sixty years is lower than over the twenty years used by Idaho Power which reduces the estimate of annual average generation and increases estimates of energy costs. Tr. pp. 300-301.

Staff witness Faull's analysis of the Milner costs also used capital structure and rates from the recent avoided cost case (Case No. IPC-E-89-11; Order No. 23357) which resulted in use of a weighted cost of capital of 11.447% (as opposed to the Company's use of a 10.857% cost).

Staff also used an estimated annual operations and maintenance cost of \$815,780; annual average generation for the Milner project of \$186,395 mwh per year (as indicated in the Company's first FERC license application); an escalation rate for determining cost of resources of 4.5% per year, and; a property tax rate of 0.7381%.

According to Order No. 23357, the maximum avoided cost rate available to qualifying facilities purchasing from Idaho Power and coming on line in 1992 is \$57.53 mills/KWh. In spite of this, Faull believes that its estimated cost for the Milner project of \$62.73 mills/KWh still indicates that Milner is a cost-effective project. For at least three reasons, the published avoided cost rates are inappropriate for direct comparison to a cost estimate of a specific project. First, the computer model that computes the published avoided cost rates assumes a "first deficit year" (i.e., year of new resource need) of 1993 for Idaho Power. Staff believes, however, that the correct first deficit year should have been 1994.

Second, the published avoided cost rates include an adjustable portion of \$8.78 mills/KWh that will be adjusted in the future based on actual operating costs of the Colstrip coal-fired generating plant. For direct comparison to an actual project, the adjustable portion should be assumed to escalate at the same rate as comparable costs associated with the actual project.

Third, even as adjusted above, Staff argues that the published avoided cost rates apply only to projects with a twenty year availability to Idaho Power. Although there have been numerous arguments made about the unfairness of limiting QF contracts and their rates to twenty years, nonetheless, Staff believes that from a ratepayer's viewpoint, Idaho Power's project should be compared to 46 years of avoidable costs. That is, when Idaho Power Company builds a resource with a 46-year life, ratepayers can reasonably expect that they will have access to the energy from that resource for the full 46 years so other resource costs can be avoided for that time period. Taking into account the foregoing adjustments as well as the seasonal weighting of avoided costs reduces the value of the avoided costs applicable to Milner to \$61.35 mills/KWh.

Thus, the Milner plant, with an estimated cost of \$62.73 mills/KWh is cost effective within reasonable limits of estimating accuracy. ($62.73 \div 61.73 = 102.2\%$). Faull would not consider the Milner project cost effective when compared to 20 year avoided cost rates in effect before Order No. 23357 if the Commission so ordered. Tr. pp. 308. Under those circumstances, Faull believes the Company should be limited in its recovery to an accurate Commission determined comparable avoided cost rate. Tr. p. 308. Further, the Commission could impute additional conservation or demand side resources to Idaho Power in evaluating the need for a supply-side resource, thereby making the project less attractive. Tr. pp. 309-310.

In addition to its analysis of the cost effectiveness of the Milner project, Faull also provided an engineering opinion relative to whether Idaho Power has provided the most cost effective development practicable for this resource. Faull does not believe that Idaho Power has made the same level of project optimizing effort that one would find in a QF development. First, Faull considers Idaho

Power's royalty agreement with the Canal Companies as a "weakness." Even though the irrigators were faced with mandatory dam repairs and a hydroelectric project that could not be made cost effective under avoided cost rates extant at the time, the final royalty agreement not only assures the Canal Companies that they will recover all of their costs of dam repairs, it also assures them of a substantial profit on their investment. Faull believes that the irrigators would have ended up with only partial reimbursement for their dam costs, not a profit, if dealing with a QF developer. Tr. pp. 312-313.

Second, Faull believes that the Milner plant has been oversized for the water flows at the site. The overall average capacity factor of the project is less than 36% and the average estimated capacity factor in the most productive month (December) is less than 60%. The standard in the industry is typically for overall capacity factors between 45% and 65%. Tr. p. 313.

Finally, Staff takes exception to Idaho Power's use of the standard firm bid process to procure equipment and construction services rather than the more cost effective request for proposals ("RFP") and negotiation process. Under the Company's method, the design engineer is constrained to "guessing" about the best combination of size, arrangement and timing with minimal input from suppliers whereas in a competitively negotiated contract based on a request for proposals, the suppliers are challenged to provide their most innovative combinations with fruitful give-and-take discussions between the suppliers, owners and the engineer. RFPs also reduce the probability of suppliers receiving cost overrun payments for extra work, unexpected conditions and ambiguous contract language. Tr. pp. 313-314.

Idaho Power rebuts that the use of the standard firm bid process has the following advantages:

- (1) Project design can be tailored to the owners needs;
- (2) Contingencies to cover development risk are not required because the purchase and contracting is phased to the design progress;
- (3) Developer mark ups on equipment purchased from the manufacturers are eliminated;
- (4) The owner retains control of the combination and quality of equipment purchased;
- (5) Changes to the project can be made based on site conditions without having to renegotiate the project development package, and;
- (6) Proposals received for the development or any part of the package are competitive proposals where bidders have eliminated contingency amounts to cover later negotiation.

Tr. pp. 57-59.

Staff concedes that Idaho Power's royalty agreement with the Canal Companies is not entirely disadvantageous. The royalty agreement has two components, a base royalty and an incentive royalty. The base royalty assures the irrigators of recovering nearly all of the costs of repairing the dam. This is the component which Staff feels is excessive. The incentive royalty, on the other hand is very beneficial to ratepayers. It provides the irrigators with a strong financial incentive to limit their water use during good years and even provides some incentive for irrigation efficiency during moderate water years. Water that is not consumed by the irrigators has a secondary value as it passes through turbines at Milner and other downstream plants. Tr. pp. 314-315.

In summary, Staff believes that the Commission should grant a certificate for the present public convenience and necessity for the Milner plant.

Faull's criticisms of the Company's management practices do not constitute evidence of imprudent management. Faull believes, however, that the Company should be held to the standard of avoided cost in determining the ratemaking allowability of new resource costs and should be required to fully justify its management and construction decisions prior to such costs being allowed for ratemaking purposes. Staff further asserts that the issuance of a certificate should not imply that all costs incurred in developing the project are inherently prudent. The Commission, Staff believes, must review all costs incurred at a later date and determine at that time whether Idaho Power's execution of the project was prudent in light of the generally accepted standards of the hydroelectric construction industry. Tr. p. 317.

Faull rejected the Company's alternative of exempting the Milner project from regulation for a twenty year period. His rationale was that, since the project is cost effective under comparable avoided cost rates, it should be included in the Company's resource stack at this time. Tr. pp. 317-318.

Even if estimated project costs exceeded avoided costs, Faull believes that the concept of an exempt status for Milner presents certain problems and risks. For example, it would be extremely difficult to establish a completely independent, non-regulated subsidiary with clear controls to assure that there can be no cross-subsidization between the subsidiary and the regulated utility. Tr. p. 318-319.

Staff witness Stephanie Miller testified that, based upon the analysis of Tom Faull, the Commission should grant a certificate for the present convenience and necessity for Milner. Tr. p. 405. She argues that the issuance of a certificate does not guarantee that the amount of \$63,350,600 will necessarily be included in ratebase. If the Company is able to construct the project for less,

it would, of course, only be entitled to ratebase that amount. Moreover, only construction costs found prudent by the Commission will be allowed into ratebase. Tr. pp. 405-407.

Miller argues that the granting of a certificate simply means that the Company may proceed with construction with the understanding that the plant will ordinarily be included in ratebase if major changes in either the cost of the project or the environment in which the Company operates do not occur between granting the certificate and the completion of the project. *Id.*

From a policy standpoint, Idaho Power should be reminded that a certificate is not an order to complete a project. It is authority to proceed with a project, not a guarantee that it will be ratebased. If major project scope or escalation changes do occur, or if the Company's projected power needs change, the Company should use its good management judgment to decide whether to proceed. The filing of quarterly construction reports keep the Commission and Staff apprised about progress on the project. The Commission is not in the business of managing the Company's construction program, however. The Company should not be insulated from charges of mismanagement if it has completed a certificated plant under circumstances that have changed since the issuance of the certificate that would warrant some type of mitigating efforts on the part of the Company. *Id.*

By the same token, the Company should not be asked to bear all costs of the plant on its own if there are changed circumstances and the Company reacts prudently to those changes. *Id.*

Miller feels that Idaho Power's proposed alternative for exempt status for the Milner plant is new and innovative. It may serve as a vehicle for allowing the Company to develop future resources within its service territory before they

are captured by out of state interests and even though the resources are not currently needed on the Company's system, e.g., Lucky peak dam. Tr. pp. 407-408.

Miller does have several concerns, however, about the manner in which an exempt status would operate. First, she feels that the Commission should not commit, at this time, to any methodology of valuing the new plant when it is put into ratebase at the expiration of the exempt period. She is particularly concerned about the use of reproduction cost new less depreciation. The Idaho Commission has generally subscribed to the "original cost" theory of ratemaking in allowing plant into ratebase at the time it is devoted to public service. The use of reproduction cost will, in all likelihood, produce a price that will not reflect the true value of the plant to be acquired by ratepayers when it is dedicated to their service. Determining reproduction costs twenty years into the future ignores contemporary products and new technologies that may be available twenty years from now. Not only might the physical plant be quite different, but labor and construction methods used to construct a plant might also have changed significantly. This may render the plant obsolete, require increased maintenance expense and would not be the most valuable plant for generating power because technological improvements had resulted in reduced costs, better designs and enhanced ability to provide service. Tr. pp. 408-412.

In the event that the Commission chose the alternative of exempting Milner from regulation, Miller believes that the Commission's order could contain the general statement that the Commission will determine the value of the plant for ratemaking purposes at the time it is dedicated to Idaho ratepayers. Tr. p. 412.

As an alternative, Miller proposes to bring the plant into ratebase at original cost less depreciation accrued using the annuity method. The annuity method levelizes the capital costs of a project over the project life by applying low depreciation rates in early years when required return is high and high depreciation in later years when required return is lower. This approach would have the advantage of relying on verifiable booked costs but would recognize that any power sale made by the Company would probably be based on the levelized cost of the project. Tr. pp. 412-413.

Even if the project does not appear to be currently cost effective to Idaho Power's customers, but appears to be a good long term resource, Miller still recommends approval of a certificate of public convenience and necessity by the Commission. Her rationale is that if someone other than Idaho Power builds the plant, the Company's ratepayers will have no option on the facility and any option is better than no option at all. Tr. p. 413.

Finally, Miller has concerns over Idaho Power's operation of the Milner plant in the event that the Commission chooses to exempt the plant from regulation and it is operated through a subsidiary. Miller's concern, like that of Staff witness Faull, is that there must be no subsidization of the subsidiary by the utility and its ratepayers. At a minimum, the Staff would have to have access to the power sales contract signed by the subsidiary to determine exactly what the conditions of the power sales contracts are. The Staff would also require access to the books of the subsidiary to trace transactions. Even with careful segregation of costs and cost allocations between the subsidiary and the utility, there would still be aspects of the relationship that would be unquantifiable but that might very well result in higher prices obtainable by the subsidiary for its power. Miller suggests that the Commission could incorporate

any necessary language into the certificate of convenience and necessity which may be issued for the future and not merely for the present. Tr. pp. 313-415.

In cross-examination by Idaho Power, Miller testified that a particularly strong case could be made for valuing Milner at original cost, less depreciation, if it were given exempt status and then operated under the FERC or Oregon jurisdictions, as suggested by Idaho Power witness Keen. Her rationale is that, under this scenario, the Company would have been recovering a full return on its investment, plus depreciation, in the initial twenty years. Tr. pp. 430-432.

The Staff's final witness was Bill Eastlake, an economist. He addressed policy considerations that the Commission may consider in reaching its decision in both the Milner and Swan Falls cases. According to Eastlake, ratepayers are not buying a simple, undifferentiated product (electrical generation) that is so standard that the only important factor in the purchase decision is price. The projected costs from the Milner project are approximately those of comparable avoided costs for purchase from cogenerators and small power producers. Idaho's hydroelectric base has allowed Idaho Power and other utilities serving the state to remain among the lowest cost utilities in the country. Where possible, it is desirable to keep local control of resources like low cost hydropower so that their benefits are not reaped by utilities and ratepayers out of state.

The State Energy Plan places a high priority on conservation and renewables, with emphasis on improving existing resources such as retrofitting dams with power generation facilities. The plan does not have the force of law but the resource policy that developed it clearly indicated a preference

for getting more hydroelectric power at existing dams. The same preference for hydroelectricity should hold today, nearly a decade after the energy plan was established in February 1982.

In addition, policy 1C of the State Water Plan which does have the force of law because it was approved by the Legislature, designates non-consumptive uses of water for hydrogeneration as beneficial. This is a striking departure from previous narrow definitions of beneficial use that emphasized removal of water from the river, usually for irrigation.

INDUSTRIAL CUSTOMERS OF IDAHO POWER (ICIP)

Dr. Reading believes that the Company provided little evidence concerning the cost effectiveness of the Milner project or showing that the project is the least cost alternative available to ratepayers. Dr. Reading testified that if the Commission grants the Company's request for pre-approval for ratebase treatment for Milner, it will effectively foreclose its ability to examine the prudence of the Company's decision making between the time reconstruction begins and the time the project is completed. The Company's management will be unconstrained by changes in load, technological progress or economic feasibility of the plant. Idaho Power has no right to automatic inclusion of the project in ratebase simply because it follows reasonable and prudent construction practices. This ignores the Company's management obligations in other areas.

Dr. Reading characterized the Company's proposed cap of a "commitment estimate" as superficially appealing yet hollow because adjustments for documented changes in escalation rates or scope caused by (1) *force majeure* or Acts of God, (2) design optimization for increased energy, or (3) foundation or site conditions significantly more expensive than indicated

by exploratory drilling are not covered by the cap. The commitment estimate, therefore, is not an upper limit of the project's cost that could be included in ratebase.

Dr. Reading argues the Company's proposal assigns most of the risk of constructing the Milner project to the Company's ratepayers while eliminating most of the risk to its stockholders. The only risk faced by stockholders is that the Company would not use reasonable and prudent construction practices which could result in some of the plant being disallowed if investment exceeded the cap.

Dr. Reading contended that reduced equity costs are associated with reduced risk. Therefore, if the Company's true equity risk for a pre-approved plant is 10% (1 percentage point above the risk-free cost of capital), the Company's overall equity cost for all of its plant should be reduced about 25 basis points.

Although Dr. Reading believed it is inappropriate to determine ratemaking methods to be used for a plant not yet constructed, he noted that traditional ratebase/rate of return regulation is not the only option. For example, the Company's avoided costs could also be considered as a fair rate cap for ratepayer's costs. Fair market value of the plant and the cost of alternative forms of reliable power could also be considered.

In addition, Dr. Reading finds the Company's alternative proposal for exemption of Milner from regulation to be troublesome. He questions the integrity of the Company's proposal since the Company does not make the same offer for the Swan Falls project for which the estimated cost per kilowatt is nearly triple. Idaho Power and its stockholders would benefit from the economics associated with a deregulated Milner, while ratepayers would defray the relative

high costs of Swan Falls. This, Reading argues, may be good private business but is not good public policy. Tr. pp. 213-215.

Reading also objects to the Company's proposed methodology for valuing the Milner project at the end of the exemption period. Adoption by the Commission of the Company's proposal would be tantamount to guaranteeing the Company's shareholders a substantial gain on the project at the expense of ratepayers. Reading recommends that if the Commission decides to exempt Milner, it should set the buy-back rate at the lesser of the original cost less depreciation or fair market value. Tr. pp. 214-215.

Reading's recommendations and conclusions can be summarized as follows. Reading rejects the Company's interpretation of a certificate of public convenience and necessity, that a certificate means that the Company's decision to construct the Milner project is reasonable and prudent and in the public interest. To the contrary, the Company's mere use of reasonable and prudent construction practices, once granted a certificate, does not guarantee inclusion of the Milner project in the Company's ratebase. Such an interpretation is in contradiction with the Commission's decision concerning Valmy II. It would require the Commission to ignore many relevant circumstances that would otherwise force the Company to alter its initial course of action. The Commission would be barred from addressing the prudence of the Company's management decision making process during the construction. Tr. pp. 218-223.

If the Commission does adopt the Company's interpretation of a certificate, then it should reject the Company's Application on the grounds that it is deficient. The Company's Application has not shown that the project is economical, that it is the least cost alternative or that it is even needed. *Id.*

The Company's proffered cap on construction costs is an inadequate consideration for pre-approval for ratebase. The escalation and scope reservations attached to the cap render it without value. *Id.*

The Company's proposal saddles ratepayers with most of the risks of construction. Despite this, the Company has not offered to lower its cost of equity. If the Commission adopts the Company's proposal to pre-approve ratebase for Milner, it should adjust the Company's cost of equity downward to be consistent with its reduced risk. *Id.*

The Commission should also reject the Company's alternative deregulation proposal. The Company has not shown this to be in the public interest. The capital cost of the Company's Swan Falls project is almost three times higher than Milner. In spite of this, the Company does not offer an alternative deregulation proposal for Swan Falls. Furthermore, the Company's unfair buy-back proposal almost guarantees stockholders a windfall gain at the expense of ratepayers. If the Commission is inclined to adopt the Company's proposal, then it should set the buy-back rate at the lesser of original cost less depreciation or fair market value. *Id.*

Finally, Reading urges the Commission to consider avoided costs as a reasonable upper limit when valuing Milner for ratebase treatment, if that occurs. *Id.*

IDAHO CONSUMER AFFAIRS, INC. (ICA)

ICA participated in cross-examination of other parties witnesses during the hearing but did not present any witnesses of its own. Pursuant to agreement reached at the hearing, ICA filed written comments on December 5, 1990.

ICA stated its position that conservation should still be the preferred source of additional generating capacity. ICA was not convinced, however, that

conservation should be the sole new source of Idaho Power's additional generating capacity. ICA believed that hydroelectric generation and fish and wildlife protection and enhancement are beneficial uses of water. ICA believed that hydroelectric projects, when constructed as upgrades, are reasonably environmentally acceptable. Milner and Swan Falls should not become lost opportunity for the needs of Idaho and the Pacific Northwest. In addition, hydroelectric projects operating a maintenance costs are far less than thermal plants, they do not contribute to acid rain, air pollution, fly ash or waster disposal problems, their fuel (water) is considerably cheaper than coal or uranium, their plant life is considerably longer and they do not consume water in the river.

Idaho Power needs to plan for additional hydroelectric generation particularly because the Canadian share of power from the Columbia River will revert to British Columbia beginning in 1998. Even if British Columbia decides to sell this power in whole or in part to the United States, the cost will most assuredly rise.

With regard to lost opportunities, Idaho Power should capture the benefits of the Milner and Swan Falls projects now to secure them for the future. If the electricity they produce is sold off-system at a reduced rate in the short-term, then the plant should not be ratebased until it becomes used and useful for Idaho Power's ratepayers. The crossover point for Idaho Power's need for new generation is approximately 1998-1999, according to Idaho Power testimony in the avoided cost case.

AFTON ENERGY, INC. ("Afton")

Afton did not participate in the Milner hearing. Its sole act in this case was the filing of written comments on August 31, 1990.

Essentially, Afton states that it has excess capacity and energy available to sell to Idaho power and that it wants a level playing field on which it has the same ability to provide the Company's ratepayers with energy measured against a 20-year contract, cash escrow guaranteeing performance and other provisions applying to QF's.

Afton argues that Idaho Power's proposed front-end loading of costs including depreciation and return on equity is not the least cost alternative for new generation when compared with power purchased from a PURPA QF at avoided cost. If Idaho Power contends that Milner presents a unique benefit, then its shareholders should pay for such a benefit, and to the ratepayers through higher energy costs.

PUBLIC TESTIMONY

The sole public witness to testify at the hearing was DeWitt Moss, Director of the North Side Canal Company. Mr. Moss explained that revenues to the Canal Companies from Idaho Power will provide for rehabilitation of the dam, which serves 500,000 acres of farm land.

On examination by Staff, Mr. Moss stated that the Canal Companies could not obtain financing for the needed rebuild of Milner without Idaho Power's assistance. Tr. pp. 161-164. Moss also believed the incentive royalty would help to foster conservative water consumption by the irrigators. Tr. p. 165.

COMMISSION DECISION

WE FIND:

Certificate of Public Convenience and Necessity

The Company's cost estimate, as well as Staff's independent cost analysis, indicate that the Milner project will be cost effective when compared with comparable avoided cost rates. No evidence was submitted to the contrary.

This fact alone might be sufficient justification for this Commission to issue a certificate of public convenience and necessity for construction of Milner as Idaho Power approaches load resource balance.

There are other attributes or benefits, however, that are somewhat unique to Milner. Staff witness Eastlake highlighted the State of Idaho's interest in developing its hydro resources; particularly those that can be obtained through retrofit of currently existing facilities. The rationale for this is quite obvious. Snake River hydro has graced Idaho Power's ratepayers with some of the cheapest power in the nation. A resource such as Milner is especially appealing where it is relatively environmentally benign. The retrofitting of a currently existing dam certainly has less of an adverse effect on the environment than construction of a new dam or of a coal-fired or nuclear plant. There is no doubt in our minds that Milner represents a rare opportunity for the state of Idaho to obtain relatively inexpensive power with little impact on the currently existing environment.

Regardless of whether Milner is "non-deferrable" in the true sense of the word, it is a resource that we feel that Idaho Power should be allowed to capture for the benefit of the people of Idaho. Such resources are certainly desirable to out-of-state utilities and developers who, quite likely, would develop these sites if Idaho Power does not.

Regarding Idaho Power's agreement with the canal companies, we find that the bargain struck appears beneficial to both parties. It is not unreasonable for Idaho Power to enter into this type of an arrangement in order to capture the opportunity to develop a resource such as Milner.

Based upon the foregoing, we find that the Company shall be issued a certificate for the present public convenience and necessity to develop the Milner project. Along these lines, we note that the Company has invested millions of

dollars in this project prior to obtaining this certificate. *Idaho Code* § 61-526 clearly requires the Company to obtain a certificate of public convenience and necessity prior to beginning the construction of a plant. In future cases, Idaho Power should obtain its certificate prior to incurring investment costs beyond the evaluation stage.

Revenue Requirement

Idaho Power structured its Application such that, implicit in the issuance of a certificate for public convenience and necessity by this Commission, was the understanding that all investment prudently incurred by Idaho Power in Milner would be included in the Company's rate base.

The Commission Staff and ICIP, on the other hand, assert that it is inappropriate to assure the Company, in advance, that its investment in Milner will be ratebased. This, they argue, eliminates all the risks of constructing the project for the Company's shareholders and places those risks on the ratepayers.

This posturing by the parties defined the paramount legal issue in this case: "What is the import of a certificate of public convenience and necessity?" We are not compelled, practically or theoretically, to render a decision on this issue in the context framed by the parties. Indeed, it would be unwise to attempt a "bright line" definition of the rate implications of a certificate of public convenience and necessity. Idaho Power's projects can and do vary dramatically. The risks inherent in constructing a coal-fired or nuclear facility are greater in magnitude than those involved in construction of Snake River hydro. The latter, to say the least, has a track record of proven and reliable technology. The construction time for a project such as Milner is quite brief relative to construction of other power plants. Extraordinary changes in circumstances are

less likely to occur in a shorter period of time. In short, Milner does not take us on a flight into the unknown. For further discussion, see Order No. 23520 issued in Case No. IPC-E-90-2 (Swan Falls Case).

Therefore, we can offer the Company greater assurances of some form of cost recovery when issuing a certificate for a project such as Milner than we could for, perhaps, a coal or nuclear facility. This is not to say, however, that we can guarantee Idaho Power that all of its investment in Milner will be ratebased. Changes in the physical, political, and technological environs in which the Company operates could possibly dictate that design modifications be made or that construction ceases completely. The Company is obligated to exercise good management judgment in this regard.

Therefore, the parties are instructed that, in the ordinary course of events, the Company may expect its investment in the Milner project to be recognized in its revenue requirement, barring unforeseen circumstances of a kind uncharacteristic of hydroelectric facilities. Further, the Company's incurrence of costs for preliminary site and engineering work through its commitment estimate is reasonable and prudent and will later be recognized in revenue requirement.

Rate of Return

ICIP recommended that if the Commission acknowledged in this Order that the Company's investment in the Milner project should be recognized in its revenue requirement, then its equity return should be adjusted as well. We disagree.

Accordingly, we find that Idaho Power's rate of return should not be reduced from what it otherwise would be by our acknowledgment that its

investment in the Milner hydroelectric facility will be recognized in revenue requirement barring extraordinary circumstances.

Certificate of Exemption

Regarding the Company's alternative proposal for a certificate of exemption, we believe that the lack of a statutory basis for the issuance of a certificate of exemption does not preclude this Commission from issuing the functional equivalent through the issuance of a certificate for the future public convenience and necessity, as authorized pursuant to *Idaho Code* § 61-526.

Because of our decision to issue a certificate for the present convenience and necessity, it is not necessary to resolve all the issues raised by the Company's alternative proposal. We express our concerns how such an arrangement would operate. Specifically, we echo the concerns of Staff about the manner in which the plant would be valued when it was dedicated to the Company's ratepayers in the future. We agree with Staff witness Miller that the use of reproduction cost is fraught with uncertainties and vagaries. It also appears that it would be difficult to devise a depreciation method that would be fair to both the Company and its ratepayers.

We are also concerned with the potential for cross-subsidization between the utility and the entity operating the plant under an exempt status. These concerns would have to be worked out through innovative and cooperative efforts by the Company and the Commission Staff.

O R D E R

IT IS THEREFORE ORDERED that the Idaho Power Company is granted a Certificate for the present public convenience and necessity for the Milner hydroelectric facility and is authorized to proceed with construction on that facility.

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. IPC-E-90-8 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. IPC-E-90-8. 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 *19th* day of January 1991.



DEAN J. MILLER, PRESIDENT



PERRY SWISHER, COMMISSIONER



RALPH NELSON, COMMISSIONER

ATTEST:



MYRNA J. WALTERS, SECRETARY

BP:nh/O-1275