

Idaho Published Avoided Cost Rates

Impacts of Increasing Project Size and Contract Length

Current Rate Methodology

A federal law called PURPA (Public Utilities Regulatory Policy Act of 1978) requires Idaho electric utilities to purchase electrical generation from Qualifying Facilities (QF) under conditions set by the Idaho Public Utilities Commission. Currently, small power projects of 10 Megawatts (MW) or less are eligible for standard contracts at rates that remain constant for 20 years. That rate represents a forecast of what the utilities would pay for energy on average over the 20 years if they didn't purchase from the QF projects.

The forecast assumes that the utilities would construct a natural gas fired power plant or purchase electricity from someone who did. Therefore, the price paid to QF developers is based on the cost to build a gas-fired power plant and the natural gas needed to run it.

Forecasting the price of electricity for the next 20 years using a gas fired power plant requires that a starting price for natural gas be determined and then adjusted over the 20-year period to simulate what natural gas is expected to cost in the future. That stream of costs over 20 years is then converted to a constant rate to be paid to the project developers. The current rate is \$53.14/Megawatt hour (Mwh), approximately the same for all Idaho utilities.

Uncertainty and Price Risk

Obviously, the published rate is only an estimate of what electricity costs will be over the next 20 years. Actual costs for electricity could be significantly different from the prices paid to developers under contract. In addition, the published rate for new contracts will change each year as the starting price and escalation rate for natural gas changes.

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For example, the current rate assumes that natural gas costs will increase by 2.4% per year for the next 20 years. If gas costs actually increase by only 1.5% per year, developers with a 20 -year contract and 10 Mw project would be over paid by about \$220,000 per year. If the actual gas escalation rate were 4% per year, developers would be underpaid by about \$400,000 per year. The risk of over payment is borne by the ratepayers, the risk of under payment is borne by the project developers.

Another uncertainty in establishing the published rate is the starting price for natural gas. The starting gas price was just recently changed to reflect current market prices. It went from \$3.75 per unit to \$4.40 per unit. This change increased the published rate and the amount paid to developers by about \$300,000 per year for a 10 Mw project with a 20-year contract. The point

here is that high (or low) gas prices when the power contract is signed could produce inappropriate rates throughout the contract term.

The risk that published rates will be too high or too low is increased if we move from the current 20-year contracts to 30-years. While 30-year contracts produce slightly higher levelized electric rates, they are likely to be less accurate because current gas prices and forecasted escalation rates are more suspect the farther we project them into the future. Increasing the length of the contract in combination with increasing the project size compounds the magnitude of over/underpayment risk that occurs under currently approved avoided cost methodology.

Higher Idaho Rates Attract Out of State Projects

–Current rates and terms available in Idaho are more attractive than those of surrounding states. In addition, the federal law that allows states to set avoided cost rates does not allow utilities to discriminate against out of state projects once the state commission establishes the published rate.

Idaho utilities must pay the published rate to all any qualifying projects regardless of project location provided the generation can be delivered to the utility service area. There is no limit on the amount of power that must be purchased at the published rate under PURPA. Published rates and mandatory contract terms in surrounding states are as follows:

State	Published Rate	Maximum Project Size	Maximum Term
Idaho	\$53.14/Mwh all hours	10MW	20 Years
Washington	Market Price	No limit	No Mandatory
Oregon	\$48.7/Mwh On Peak \$33.8/Mwh Off Peak	1MW	5 years
Wyoming	\$17.40/Mwh Escalated/Nonlevelized	1Mw	20 years
Utah	\$51.9/Mwh	1Mw	20 Years

The published rates and terms now offered by Idaho are significantly higher than surrounding states and may attract projects from outside Idaho. Increasing the rate, maximum project size and contract term will make Idaho rates even more attractive to projects outside the state. Idaho Power currently purchases 26 Mw (15% of all its QF purchases) from outside the state.

Summary

The methodology approved by the Commission to establish avoided cost rates requires a forecast of natural gas prices that are locked-in for the term of the contract. While locking-in the forecast and levelizing rates over the term of the contract provides price certainty and accelerated cost recovery for developers, it also creates risk that the prices paid will not reflect costs that the utility actually avoids. As contract terms are lengthened and project sizes increase the risk and magnitude of over or underpayment for generation increases.

The published avoided cost rates and contract terms currently available from Idaho electric utilities to small power developers are more attractive than those available in any of the surrounding states. Increasing contract term and project size will further increase rates relative to those available from utilities in other states with the potential to attract projects located outside Idaho. In an effort to develop more projects in Idaho, increased rates and availability may simply increase costs to Idaho electric customers through development of more out of state projects.