

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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**IN THE MATTER OF THE PETITION OF §
THE COMMISSION STAFF REQUESTING §
THAT THE COMMISSION INVESTIGATE §
THE BUY-BACK RATES IN THE LETTER §
AGREEMENT ENTERED INTO BY IDAHO §
POWER COMPANY AND ASTARIS LLC. §**

CASE No. IPC-E-01-43

DIRECT TESTIMONY OF RONALD J. BINZ

ON BEHALF OF

ASTARIS

JANUARY, 2002

1 **Q. What is your name and address?**

2 A. My name is Ronald J. Binz. My business address is 333 Eudora Street, Denver,
3 Colorado 80220-5721.

4 **Q. On whose behalf are you testifying in this case?**

5 A. I am testifying on behalf of Astaris LLC, Astaris Idaho LLC and FMC
6 Corporation (collectively “Astaris”).

7 **Q. What is your occupation?**

8 A. I am President of Public Policy Consulting, a consulting firm specializing in
9 energy and telecommunications regulatory matters. I provide consulting services to a
10 variety of public-sector and private-sector clients in the energy and telecommunications
11 industries, primarily in the regulatory arena. My consulting practice dates to 1977,
12 except for the period of 1984-1995 when I served as Colorado Consumer Counsel.

13 I am also the President of the Competition Policy Institute (CPI) in Washington,
14 D.C. CPI is a non-profit organization that Debra Berlyn and I founded CPI in March
15 1996 and describe as a combination consumer group and “think tank.” CPI’s activities
16 have included advocacy before regulators and lawmakers, education, research and
17 working with other consumer organizations. We recently suspended our federal
18 advocacy work, focusing our efforts on the educational role of the organization, with
19 plans to host several symposia this year on telecommunications and energy policy for
20 state regulators and state legislators.

21 **Q. Please summarize your experience in utility regulation.**

22 A. For eleven years prior to Public Policy Consulting and CPI, I was Consumer

1 Counsel for the State of Colorado. In that role, I represented the interests of residential
2 and small business consumers of telecommunications and energy before the Colorado
3 Public Utilities Commission, the Federal Communications Commission (FCC), the
4 Federal Energy Regulatory Commission (FERC), the courts and legislative bodies.

5 During my tenure as Consumer Counsel I served as the President of the National
6 Association of State Utility Consumer Advocates (NASUCA) for two years and chaired
7 the organization's Telecommunications Committee for three years. In those roles (and at
8 CPI) I have testified numerous times before Congressional committees on energy and
9 telecommunications matters.

10 Prior to my work with the Office of Consumer Counsel, I was a consulting utility
11 rate analyst. I have testified before regulatory commissions, courts and arbitration panels
12 in Colorado and in other western states on behalf of a variety of clients. These include
13 consumer organizations, senior citizen groups, agricultural utility consumers,
14 homebuilders, telecommunications resellers and local governments.

15 I am a frequent speaker and presenter at industry, regulatory and legislative
16 conferences and symposia. I am a member of the Harvard Electricity Policy Group and
17 recently served on two advisory commissions to the Federal Communications
18 Commission. My resume is attached as Binz Exhibit No. 207 to this testimony.

19 **Q. Have you been involved in regulatory cases involving issues similar to those**
20 **raised in this case?**

21 A. Yes. I was involved in several cases in Colorado with elements in common with
22 the issues raised here. In the early 1980's I was an expert witness on behalf of consumer

1 intervenors that challenged the inclusion in rates of the Fort St. Vrain nuclear generating
2 station of Public Service Company of Colorado. I testified before the Colorado Public
3 Utilities Commission in a series of cases involving the rate base treatment of that plant
4 and the costs of replacement power. As Consumer Counsel I pursued the same matter,
5 with the issue culminating in a 1986 settlement that removed the plant from the utility's
6 rate base and provided refunds and rate reductions for consumers. While I was
7 Consumer Counsel, the office was involved in numerous adjudicated cases and
8 rulemakings involving purchased power, Least Cost Planning, Integrated Resource
9 Planning and Demand Side Management, in which the issues of the prudence of utility
10 resource acquisitions was examined. I was responsible for the agency's policy position
11 on all these matters and directed the legal and technical staff. While an officer of
12 NASUCA, I dealt with the policy issue of prudence reviews for electric resources in our
13 dealings with NARUC, EEI, and utility associations and also in legislative proposals. I
14 testified before the Texas Public Utility Commission on its consideration of an integrated
15 resource plan and before the Georgia Public Service Commission in electric and gas
16 resource planning dockets.

17 **Q. What is the purpose of your testimony in this case?**

18 A. I was asked by Astaris to review the petition of the Staff of the Idaho Public
19 Utilities Commission ("Staff") recommending that the Commission abrogate the buy-
20 back contract ("Letter Agreement") between Idaho Power Company ("Idaho Power") and
21 Astaris. I was asked to render an opinion as to the policy soundness of Staff's
22 recommendation and to make my own recommendations to the Commission based on my
23 experience and my review of this and related cases in Idaho. I was not asked to render a

1 legal opinion in this matter (since I am not an attorney), but rather an opinion informed
2 by my experience in the regulatory arena, much of it representing consumers.

3 **Q. What did you review in preparation for this testimony?**

4 A. I reviewed numerous documents in preparation for this testimony including:
5 Staff's petition, supporting testimony and exhibits in this case; the applications,
6 testimonies, comments and responses in the most recent PCA proceeding; filings in the
7 matters of the Astaris agreement and irrigation buy-back; the 1973 Electric Rate Schedule
8 for FMC Corporation; and the 1997 Electric Service Agreement between Idaho Power
9 Company and FMC. I also have reviewed additional background material including
10 Idaho Power Company's FERC Form 1, Idaho Power's tariffs, and material published on
11 the websites of the Commission, Idaho Power Company, Astaris and FMC Corporation.

12 **Q. Please summarize the conclusions of your review.**

13 A. After reviewing the record in these matters, I have drawn these conclusions about
14 the Letter Agreement and Staff's Petition asking the Commission to abrogate the
15 agreement:

16 ☞ The Commission's decision to approve for ratemaking purposes the
17 purchase of buy-back capacity from Astaris at a discount to the
18 projected market price of power appears to have been based on the
19 best information available at the time. The approval of the Letter
20 Agreement as a system resource eligible for recovery through the PCA
21 followed an appropriate review by the Commission and its staff. In
22 short, regulation did its job.

23 ☞ The terms of the buy-back agreement appear to have been the product
24 of good faith, arms-length negotiations between the utility and a
25 potential supplier of capacity.

26 ☞ Astaris and Idaho Power Company conditioned the buy-back
27 agreement on the Commission's approval of the agreement. The

- 1 economic implications for Astaris and its choices for the Pocatello
2 plant were irreversibly shaped by the promise of a specific price for
3 the capacity buy-back. Changing the contract after Astaris has
4 responded to these economic implications with an after-the-fact
5 analysis unfairly undercuts the company's decisions.
- 6 ✍ Abrogating the contract between Idaho Power and Astaris could have a
7 chilling effect on future buy-back arrangements and contracts for
8 purchase power that might be necessary in Idaho. Rational sellers of
9 capacity to Idaho Power and other utilities serving Idaho would
10 prudently begin including an Idaho-specific "regulatory risk" premium
11 in the price negotiated for such capacity to account for the possibility
12 that the Commission would unwind the terms of the sale at a later date,
13 even after it had been approved.
- 14 ✍ Staff's analysis significantly overstates the benefits of the buy-back
15 agreement to Astaris. Its analysis fails to account for the payment
16 made to Idaho Power Company by Astaris under the existing purchase
17 power contract. When that adjustment is made, the prices in the Letter
18 Agreement during the balance of its term are found to represent a
19 discount to forward market prices of 33 to 66%, not merely 13.5%.
- 20 ✍ Staff fails to take into account the substantial costs undertaken by
21 Astaris to make the 50 MW of buy-back capacity available to Idaho
22 Power. When these internal costs are included, along with the
23 payment for the 50 MW, Staff's allegation that Astaris reaped a
24 windfall is seen to be wrong.
- 25 ✍ Staff calculates the rate effect of its proposal to be a reduction to
26 residential customers of only 1.70% of base rates in the 2002-2003
27 PCA year, or about 88¢ on the monthly bill of a consumer using 1000
28 kWh of electricity. This modest reduction applies to a rate that is
29 already quite low in relative terms: information from the Energy
30 Information Administration shows that Idaho's residential rates were
31 the 9th lowest in the country in 2000 and its industrial rates were the
32 3rd lowest.¹

33 **Q. What are your recommendations to the Commission?**

34 A. I have four recommendations to offer the Commission.

35 First, the Commission should deny Staff's petition. Besides the apparent

¹ Idaho Power Company's website shows similar information for July 2001. According to data posted there, residential rates in Boise were the fourth lowest of the major cities examined; small commercial rates were the fourth lowest and large industrial rates were the seventh lowest.

1 substantial questions about the Commission's legal authority to do so, there are several
2 sound policy reasons why the Commission should decline to grant the petition and
3 abrogate the Letter Agreement. While the proposal by Staff is undoubtedly intended to
4 benefit ratepayers, it is ultimately short-sighted and its benefits do not outweigh the
5 negative effects of a decision to abrogate the contract.

6 Second, instead of abrogating the contract, the Commission should use this
7 opportunity to review its preferences for the ingredients of future capacity purchases and
8 signal to Idaho utilities what it prefers to see in any future resource acquisitions. While
9 no one expects the coincidence of a severe drought and wildly fluctuating wholesale
10 market prices to recur in the near future, it would be prudent for the Commission to
11 prepare for such an eventuality.

12 The Commission's considerations might include a requirement of competitive
13 bidding, an indexed price, or a "market out" clause (essentially a call option). I would
14 not necessarily endorse the last two items since, while they might arguably protect the
15 utility buyer, they would also have the effect of increasing the price of the resource by
16 shifting risk to the electricity seller. Nevertheless, opinions differ on the best course in
17 these matters and they are certainly worthy of debate.

18 **Q. What additional recommendations do you make to the Commission?**

19 A. Next, the Commission should shift its focus from whether it can abrogate the
20 contract to a more appropriate question for a regulatory commission: Did Idaho Power
21 prudently incur the costs it proposes to recover in rates through the Power Cost
22 Adjustment? If the Commission is concerned that the buy-back agreement was
23 imprudent, the correct regulatory course is to disallow the expense for ratemaking

1 purposes, not attempt to inject regulation on an after-the-fact basis into the negotiations
2 of a third-party vendor contract.

3 Finally, if the Commission is concerned that the increase in the PCA is too great,
4 it should consider phasing-in recovery of these higher power costs over a longer period of
5 time than the one-year recovery period in the Power Cost Adjustment. If the
6 Commission believes the circumstances under which Idaho Power purchased the capacity
7 at rates that were much higher than historic levels were extraordinary and is not likely to
8 recur, spreading their recovery over a longer period of time has sound policy support and
9 precedence.

10 **Q. Before turning to the specifics of this case, please discuss how a state**
11 **regulatory commission should review resource acquisitions by a utility.**

12 A. Oversight of the acquisition of power resources by a utility is, of course, one of
13 the more important functions a regulator performs. As a general matter, regulators
14 should exercise their regulatory oversight in such cases by determining 1) whether the
15 resource is needed; 2) whether the utility has acted prudently in acquiring the resource;
16 and 3) whether the resulting costs are appropriate for ratemaking. This last decision
17 illustrates the central authority of an economic regulator on which all other authority
18 hinges: control over the prices of the regulated company.

19 Commissions should not substitute their judgment in such matters unless there is
20 evidence of imprudence on the part of the utility that it regulates. Rather, regulators
21 should focus on the *process* by which a utility acquires resources. Commissions should
22 use their ratemaking authority to induce the companies to undertake review processes that
23 result in the best resource plan, considering price, short term and long term trade-offs,

1 and potentially other issues such as environmental or economic issues. This principle,
2 that regulators should work to assure that the process is designed to yield the best
3 possible outcome, has become increasingly important in an era of a competitive
4 wholesale market for electricity when utilities are forced to build-or-buy and consume-or-
5 conserve decisions.

6 **Q. Please discuss the recent history of utility cost disallowances.**

7 A. During much of the 1980s and part of the 1990s, the regulatory world was
8 embroiled in debates about the prudence of high cost of (mainly nuclear) generating
9 capacity built by electric utilities. Advocates for consumers argued that the high costs
10 signaled imprudence on the utilities' part; the companies argued that external causes
11 drove costs higher and they had a right to recover their costs. Of course, each of them
12 could be correct, depending on the facts in a case. As it turned out, relatively little utility
13 investment was actually disallowed as imprudent, although consumers were often
14 shielded from the higher costs by a phase-in of the increased investment (with or without
15 paying the utility a carrying cost on the deferral).

16 However, I would note that when regulators made adjustments to account for very
17 high prices, they laid the blame at the feet of the utility, not on the suppliers to the
18 utilities. I am not aware of any cases where the regulators acted to terminate or modify
19 vendor contracts made by the utilities. Instead, commissions would simply cap the costs
20 that a utility could pass through or delay their recovery. To be sure, regulators may have
21 strengthened a utility's hand to renegotiate construction contracts or fuel supply contracts
22 by threatening disallowance of the costs, but those contract reformations were matters
23 between the utility and its suppliers. The renegotiation proceeded according to terms of

1 the supplier contract.

2 **Q. Please state your understanding of what happened in this case.**

3 A. In early 2001, Idaho Power was facing a power supply crisis because of curtailed
4 hydroelectric capacity due to the region's drought and resulting low water conditions.
5 The Commission had already recognized the seriousness of the situation in 2000, asking
6 consumers to conserve electricity in order to avoid shortages and higher prices.

7 In ordinary circumstances, Idaho Power would turn to the regional wholesale
8 power market to secure the needed capacity. But, in the same way that the 2000-2001
9 weather year was unusual for Idaho, the period was also exceptional for the bulk power
10 market in the western United States. Prices had reached unprecedented levels and had
11 fluctuated with a velocity that no one had predicted. It was reasonable that Idaho Power
12 look to resources other than the regional market to solve its capacity problem. The
13 utility's choice to buy back capacity from irrigators and from its largest industrial
14 customer served several purposes:

15 ☞ Needed capacity was secured that could serve other Idaho customers,
16 avoiding potential forced curtailments (brown outs);

17 ☞ The price of the capacity obtained from the irrigators and from Astaris
18 was at a discount to projected market rates; and

19 ☞ The price was locked in for two years, eliminating the risk that the
20 price would climb above the negotiated rate.

21 Following discussions in which Idaho Power had suggested that Astaris close its
22 entire production operation in Pocatello, thereby making 120 MW of power available, the
23 utility made an offer to Astaris in March 2001 proposing to buy back 50 MW of power at
24 fixed rates based on the forward price of electricity as estimated at that time. Astaris

1 accepted the offer, and the parties prepared an application asking the Commission to
2 approve the buy-back as a resource and to order that the associated costs be recovered as
3 a purchase power cost through the Power Cost Adjustment rate mechanism.

4 **Q. What did the Commission do in response to Idaho Power Company's**
5 **proposal to buy back capacity from Astaris?**

6 A. The Commission conducted an appropriate, expedited review of Idaho Power
7 Company's application. First, it issued Order No. 28678 in Case No. IPC-E-01-9 in
8 which it concluded preliminarily that the proposal was in the public interest. In this order
9 the Commission adopted an expedited procedural schedule and solicited comments from
10 interested parties on whether the costs entailed in the purchase should be passed through
11 the PCA. Following a review of those comments and considering the views of the
12 Commission Staff, the Commission issued Order No. 28695 on April 10, 2001.

13 In its order, the Commission examined and ruled on the acquisition of a resource
14 designed to address Idaho Power's acute supply shortage, finding that:

15 The Commission finds that the Letter Agreement has
16 considerable value because it allows 50 MW of reduced
17 load to be made available to serve all Idaho Power system
18 customers during this time of volatile energy market prices
19 and reduced generation capacity due to low water
20 conditions. Order No. 28695, Case No. IPC-E-01-9.

21 The Commission addressed the price of the proposed purchase:

22 The Commission also finds the price which Idaho Power
23 will pay Astaris for this reduced load to be reasonable.
24 Idaho Power proposes to pay Astaris an average of 15.9¢
25 per kWh over the term of the Letter Agreement. When
26 compared to the projected forward market prices this price
27 represents a 14.5% [sic] discount and will save Idaho
28 Power Company more than \$21,000,000 in purchase power

1 expenses if price projections for purchasing power prove to
2 be accurate. *Id.*

3 The Commission also noted that the two-year term of the Letter Agreement was
4 beneficial to Idaho consumers:

5 Furthermore, under the Letter Agreement 50 MW will
6 always be available to Idaho Power for a two-year period.
7 The value of this program is thus much greater to the
8 system than the energy sought from other programs that
9 Idaho Power is offering. The Commission finds that this
10 value justifies Idaho Power's decision to pay Astaris an
11 average of 15.9¢ per kWh or 86.5% of the projected market
12 prices over the term of the Letter Agreement rather than a
13 lower level established by a bidding process or some other
14 means as urged by many of the parties. *Id.*

15 In view of these findings, the Commission concluded that the public interest was
16 served by the buy-back and concluded that “prudently incurred payments” made by Idaho
17 Power would be recovered in rates:

18 Therefore, after reviewing the record and all the facts, the
19 Commission finds that approval of the Application and
20 attached Letter Agreement is in the public interest.
21 Accordingly, the load reduction it provides shall be added
22 to the Company's portfolio as a system resource.

23 * * *

24 The Commission finds that prudently incurred payments
25 made by Idaho Power to Astaris for purchases of energy
26 should be treated as a purchase power expense and then
27 flowed through Idaho Power's PCA mechanism. *Id.*

28 **Q. Please explain your conclusion that “regulation did its job” in this case.**

29 A. The most direct way to examine whether Idaho regulators acted appropriately is to
30 consider what the Commission might have done in addition to, or instead of, the review it
31 actually made. Since the supply situation was represented by Idaho Power Company as
32 an “emergency,” the Commission did not have the luxury of additional time and was

1 required to act expeditiously. Idaho Power did not offer the Commission a choice among
2 competing alternatives (except to decide whether the capacity was to be an on-system or
3 off-system resource). The price of the resource was below the price that the best minds
4 thought would exist in the future. Finally, the Commission Staff, acknowledging the
5 risks, supported the provision that the price be locked-in for the term of the contract. My
6 conclusion is that the Commission considered all the relevant aspects of the application
7 and acted appropriately. More importantly, it does not appear that the Commission failed
8 to take steps it should have taken.

9 There were, of course, comments from parties in the case to the effect that 1) the
10 resource acquired from Astaris should have been competitively bid; 2) that the 13.5%
11 discount from market prices was too small²; and 3) that the two-year period of the
12 agreement was too long. As noted in the quoted portions of the order, the Commission
13 considered each of these concerns and reasoned that the terms of the purchase were
14 appropriate.

15 **Q. What standard should be applied to the Commission's decision?**

16 A. It is natural to look back at past decisions to judge how they worked out. There is
17 no doubt now that the projections of future electric prices in early 2001, relied on by
18 utilities and others at the time, were wrong as predictions. Actual prices fell back to
19 historic levels later in the year. But this does not mean that the Commission erred in its
20 decision to approve these costs for future recovery by Idaho Power Company.

2 The net discount to forward market prices is actually considerably larger than 13.5% since Astaris continued to pay Idaho Power for the 50 MW of capacity the use of which Astaris agreed to forgo. The effective percentage discount changes as the forward market price varies and ranges from about 22% to about 66%. The situation is further complicated by the fact that Astaris would have been subject to the PCA recovery of its *pro rata* share of the capacity purchase as a customer of Idaho Power Company on the 70 MW balance of power it was purchasing. This would have increased the effective discount further.

1 Prices in the contract are not higher than today's projected market prices because
2 the Commission approved those rates for recovery. They are higher because Idaho Power
3 negotiated a rate designed to cap its upside exposure in March 2001, the Commission
4 approved the approach and then market prices fell. Had the price not fallen, or not fallen
5 as much, it is unlikely Staff would have come forward to ask for abrogation of the
6 contract.

7 While it may have been preferable (in hindsight, from the buyer's point of view)
8 to index the capacity price to subsequent actual market prices, Idaho Power avoided that
9 option. On behalf of its consumers and shareholders, Idaho Power needed to acquire
10 capacity and wanted to avoid the obvious risks associated with the power market in the
11 western United States in early 2001. (The utility's aversion to these fluctuations in
12 market price was demonstrated again by its decision to secure a derivative to protect
13 against the possibility that rates would change again before the Commission approved
14 recovery of the costs of the Astaris contract.)

15 In a financial transaction, shifting market risk away from the buyer will always
16 increase the price to the buyer, other things being equal. Terminating the balance of the
17 contract as proposed by Staff attempts to re-write the risk/price relationship that existed
18 when the agreement was struck.

19 **Q. Had the Commission previously adopted other measures that worked to**
20 **ensure that the capacity purchase was appropriate?**

21 A. Yes. In addition to an appropriate review of the application in early 2001, the
22 Commission had already taken steps to ensure that Idaho Power was motivated to make
23 appropriate choices in its resource acquisition. Idaho Power's PCA structure (in which

1 the Company recovers 90% of the cost of purchase power) appropriately shares the risk
2 of decisions to purchase power, inducing the Company to perform in a manner that serves
3 its shareholders' interest as well as the interests of ratepayers. Instead of simply passing
4 through the full costs of a resource the Company has acquired, the Company is motivated
5 by the PCA to acquire the resource at least cost since its shareholders will not recoup
6 10% of the difference between the cost of the resource and base energy costs. There is no
7 reason to think this provision failed to induce Idaho Power to negotiate an appropriate
8 contact with Astaris.

9 **Q. Please turn to the other party to the contract. What actions did Astaris take**
10 **in reliance on the Letter Agreement?**

11 A. Astaris's actions subsequent to the negotiated agreement are related in the
12 testimony of Astaris witnesses McCarvill and Seder. In short, Astaris substantially
13 modified its entire production process to accommodate the shutdown of one of its
14 Pocatello furnaces—the only action it could have taken to free up the 50 MW of capacity
15 sought by Idaho Power. The Astaris witnesses have quantified the direct costs of the
16 modifications to the business required by this action. Ms. McCarvill's conclusion is that,
17 to date, the company has spent more to comply with the contract than it has been paid
18 under the contract, net of the power payments made to Idaho Power Company.

19 **Q. What is the relevance of the actions taken by Astaris to perform its duties**
20 **under the contract to buy back power?**

21 A. As suggested in the earlier discussion about the role of regulation in matters like
22 this, I do not think the economics of the contract (from Astaris's perspective) are

1 especially relevant to the Commission's investigation of prudence or the contract. The
2 contract must stand on its own as a resource acquisition by Idaho Power Company. How
3 much or how little Astaris profited from the deal should not affect the determination of
4 whether the purchase was appropriate. Regulators would not undertake such an inquiry if
5 the purchase had been made from an out-of-state supplier selling in an open market.

6 While I do not think that the motivations of Astaris are particularly relevant to the
7 question of whether the Commission should abrogate the contract, Staff has put the issue
8 into play by justifying its petition in part on the theory that Astaris has reaped a windfall
9 from the transaction. As shown in the testimony of Ms. McCarvill and Mr. Seder, and as
10 illustrated later in my testimony, this is not the case.

11 Throughout this inquiry it is important to remember that Astaris is in the chemical
12 business, not in the electricity marketing business. Its decision to accept the buy back
13 terms offered by Idaho Power were driven by the internal costs of its business, not by a
14 decision to gamble in the western energy market.

15 **Q. Please describe the Staff's proposal in this case.**

16 A. The Commission Staff is requesting that the Commission abrogate the Letter
17 Agreement and order that the remaining payments to Astaris under the contract be
18 reduced to reflect the revised forward market prices used today by Idaho utilities. In
19 support of its request, Staff argues that the prices approved by the Commission
20 previously are no longer just and reasonable and that Astaris is reaping a windfall.

21 **Q. Has Staff accurately described the economics of the payments to Astaris?**

22 A. No. Staff has made two substantial errors in its calculations. First, in deciding

1 that the Letter Agreement yields prices for power sold back to Idaho Power that are
2 “200% to 700%” above today’s forward market prices, Staff has failed to account for the
3 price paid by Astaris to Idaho Power for the 50 MW of power. This omission severely
4 overstates the net amount Astaris will receive and mischaracterizes the payment to
5 Astaris in comparison to the forward market prices on which the contract is based. This
6 omission also means that, at Staff’s proposed replacement prices, Astaris would actually
7 be paid less than the forward market prices estimated in December 2001.

8 Second, in concluding that the payments made to Astaris represent a “windfall,”
9 Staff has failed to account for, or even acknowledge the relevance of, the costs Astaris
10 undertook to make the 50 MW available to Idaho Power. Staff appears to base its
11 “windfall” claim merely on the comparison of the contract prices with today’s forward
12 market prices. These two errors severely undermine the claim that the contract prices are
13 unfair and that Astaris is now the beneficiary of a windfall that did not exist in nine
14 months ago when Staff supported the contract.

15 **Q. Please discuss Staff’s error in failing to account for the payment by Astaris**
16 **for the 50 MW of power sold back to Idaho Power.**

17 A. As the Commission knows, the Energy Service Agreement (ESA) between
18 Astaris and Idaho Power Company requires the utility to make available and Astaris to
19 purchase a block of 120 MW of power at rates specified in the contract. The Letter
20 Agreement under which Idaho Power Company is buying back 50 MW of power from
21 Astaris explicitly affirms Astaris’s obligation to purchase this 50 MW at the prices in the
22 ESA. Therefore, the value to Astaris of the sale is the difference between the proceeds
23 from the sale and the payment it makes for the 50 MW of capacity that it no longer uses

1 (in addition to the costs it has incurred to perform under the contract).

2 The take-or-pay obligation under the contract is for 120,000 kWh per hour. This
3 means that Astaris pays for demand and energy related to the 50 MW capacity as if it
4 were using power at 100% load factor even though it is in fact using no demand or
5 energy in the 50 MW block. The contract demand charge is \$3.70/KW-month and the
6 energy charge is 1.665 cents per kWh plus the applicable Power Cost Adjustment.

7 **Q. Have you prepared an exhibit that estimates the payments that Astaris will**
8 **make during the period January 2002 through March 2003 for the 50 MW of**
9 **capacity?**

10 A. Yes. Binz Exhibit No. 206 estimates that Astaris will pay Idaho Power Company
11 approximately \$20.5 million for the 50 MW of capacity during this period.

12 **Q. What is the effect of this payment on the price paid by Idaho Power for the**
13 **50 MW of capacity?**

14 A. The price of the buy-back capacity in the Letter Agreement is 86.5% of the
15 forward market price of power estimated when the agreement was reached, a discount of
16 13.5% to the forward market price. However, the effective discount, after accounting for
17 the payment for the 50 MW, is quite a bit larger. As shown in Binz Exhibit No. 207, the
18 average discount for the remaining term of the contract is 43.5%. This discount varies
19 monthly because the forward market price used in the Letter Agreement varies. The
20 effective discount for the fifteen remaining months in the contract ranges from a low of
21 33.3% in January 2002 to a high of 66.6% in June 2002. I wish to stress: *these discounts*
22 *are to the forward market prices in early 2001 used in the contract.* Thus, from Astaris's

1 perspective, it was not receiving 86.5% of the then-assumed market price for the power,
2 but something much less.³

3 **Q. What effect does this omission have on Staff's recommendation that the**
4 **Commission abrogate the contract and substitute new prices based on new forward**
5 **prices?**

6 A. Staff is recommending that the Commission modify the contract by changing the
7 price from 86.5% of the March 2001 forward prices to 100% of the December 2001
8 estimated forward prices. Omitting from the calculation the payment Astaris makes for
9 the 50 MW means that the effective price paid to Astaris under Staff's proposal would be
10 substantially below the market price for power today.

11 Of course this does not mean that, if Staff makes this change, the resulting rate
12 would be fair to Astaris. As explained above and in the testimony of the Astaris
13 witnesses, the calculus used by Astaris to decide whether it would enter the contract in
14 March 2001 was based on the net revenues from the sale and considered the Company's
15 internal costs of modifying its manufacturing processes. Staff's new contract offer, even
16 if modified to account for the revenues of the 50 MW sale, would not have allowed
17 Astaris to proceed with the agreement. For that reason, the proposal is patently unfair
18 since it attempts to force on Astaris a deal it never would have made.

19 **Q. Please discuss the incentives that would accompany a Commission decision to**
20 **abrogate the Letter Agreement.**

3 The true discount to market prices is even larger when Astaris' payments are reduced further by the PCA charges it pays on the remaining 70 MW of power in the 120 MW block. This effect was noted by the Commission in Footnote 2 of its Order No. 28678, Case No. IPC-E-01-9 and was explained here in footnote 1 above.

1 A. It is often observed that utility regulation continuously provides incentives that
2 shape the behavior of regulated companies and their customers. In many ways,
3 regulation may have its greatest effect in the incentives it creates. It is important in this
4 case to consider some of the signals that will emanate from the Commission if it
5 abrogates the contract.

6 The Commission is undoubtedly aware of the major debates that have played out
7 over the years about the incentives that regulation provides. These range from the
8 academic and formal (the Averch-Johnson effect: *rate regulated companies have an*
9 *inefficiently high ratio of capital to labor*) to the common-sense (*price cap regulation can*
10 *induce companies to reduce quality of service*) to the near-political (*electric utilities have*
11 *a bias against conservation* or *TELRIC pricing eliminates the incentive to invest in*
12 *broadband networks*).

13 For better or worse, the presence of regulation in a market shapes the behavior of
14 the market participants. As much as some regulators might want to limit their role to
15 being a substitute for the competition that is missing in parts of certain industries, it is
16 rarely possible to limit regulation's effects that way. For most regulators the question is
17 not how to eliminate stray incentives in their decisions but, instead, which ones to accept.

18 This case before the Commission presents an important choice about incentives in
19 Idaho, not just for the regulated companies, but also for the companies that supply power
20 to Idaho's utilities. If the Commission decides to abrogate the contract between Astaris
21 and Idaho Power, here are some incentives that will be produced:

22 ☞ Sellers to of electricity to Idaho utilities may be more cautious about
23 entering into contracts in Idaho and will translate this wariness into a
24 "regulatory risk" premium, raising the effective cost of the transactions
25 to Idaho utilities.

1 ✍ Abrogating this contract might dissuade industrial customers (and
2 others) from negotiating capacity sales to the utility at exactly the time
3 they are most needed -- when supplies are constrained and prices are
4 high -- since those contracts would be most at risk of regulatory
5 abrogation.

6 ✍ Idaho utilities will be signaled that the Commission is willing to bail
7 them out of the effects of their decisions. This relieves pressure on the
8 companies to be effective in negotiations and prudent in their resource
9 acquisitions.

10 **Q. Are there other spillover effects that would attach to the Commission's**
11 **decision to abrogate the contract?**

12 A. Yes, there are two others. First, this case is distinguished by the facts that the
13 seller of capacity, Astaris, is also a customer of the utility and that the resource is a
14 capacity reduction, not a capacity supply sale. As mentioned earlier, it is hard to
15 conceive that the Commission would attempt to abrogate a purchase power contract with
16 an out-of-state supplier (who was not a customer of Idaho Power) especially when the
17 Commission had not found the contract to be imprudent. By interfering with this
18 contract, the Commission would be signaling that it views capacity buy-backs (and DSM
19 purchases as well) differently than supply-side resource acquisitions. This is contrary to
20 the Commission's historical view that demand-side measures should be kept on an equal
21 footing with supply-side resources

22 Finally, if the Commission accepts the theory of the Staff, any contract entered
23 into by a utility, *even one that has already been approved or even modified*, is subject to
24 abrogation by the Commission. In effect this means that no supplier to a utility could be
25 assured that a contracted-for price was secure. It is hard to say, in these circumstances,
26 what a contract with an Idaho utility would even mean. In the instant case, even the

1 reformed prices recommended by Staff could themselves be found to be “not just and
2 reasonable” a second time if market prices fall further. While there are probably
3 constraints that would prevent this from becoming too absurd, Staff’s theory puts
4 regulation on a slippery theoretic slope.

5 **Q. Please discuss the effect on consumer rates of a decision to abrogate the**
6 **contract.**

7 A. The effect on consumer rates would be modest: for the 2002-2003 PCA year, the
8 Staff estimates that residential base rates would be 1.70% lower if the Commission
9 adopts Staff’s proposal. This translates into a savings of about 88¢ per month for a
10 customer using 1000 kWh of electricity. When compared to a residential customer’s
11 actual bill, including the current Power Cost Adjustment, the reduction is about 1.33%.
12 The effect on residential rates in the second PCA year would be 3.59% (stated as a
13 percentage of base rates) or 2.81% based on rates that include today’s PCA.

14 As the former consumer counsel in Colorado, I would never advise the
15 Commission that an 88¢ bill reduction should be taken lightly. On the other hand, the
16 Commission must weigh the “savings” to consumers of such a potential reduction against
17 the costs that regulation will bear if the Commission acts to abrogate the contract. In my
18 view, the 88¢ of benefits do not outweigh these costs. As discussed above, future load
19 reductions, when and if needed, may be harder to achieve and may cost more to secure.
20 If sellers of firm capacity to Idaho Power react rationally and build a “risk-premium” into
21 their price, the 1.7% first year rate reduction could easily be swamped by this effect.

22 As the Commission is undoubtedly aware, its regulation of Idaho utilities and
23 their access to hydroelectric power has resulted in some of the lowest electric rates in the

1 country. Data from the Energy Information Administration shows that Idaho's residential
2 rates in 2000 were the 9th lowest in the country and its industrial rates were the 3rd
3 lowest. Moreover, Idaho Power's rates appear to be lower than the Idaho average. I am
4 not suggesting that rates should be raised simply because they can be raised. I only think
5 the Commission should consider the relative effects of its decision in this case.

6 **Q. If the Commission is concerned about the effect of the higher PCA on future
7 consumer rates, what options does it have besides Staff's recommendation?**

8 A. The Commission has at least two other options. First, it can consider whether
9 Idaho Power acted prudently in purchasing buy-back power from Astaris at the rate of
10 86.5% of the then-current forward prices for power. Such an investigation would focus
11 the Commission's scrutiny on the appropriate subject: the regulated company, not an
12 unregulated vendor. I am not aware of any evidence that Idaho Power acted
13 imprudently. However, an inquiry into the Idaho Power's prudence is certainly within
14 the jurisdiction of the Commission and a disallowance of a portion of Idaho Power's
15 costs would achieve the same effect as abrogating the contract.

16 In its comments filed in April 2001 in response to Commission Order Nos. 28665
17 and 28685, the Commission Staff questioned whether Idaho Power had acted
18 appropriately in the months prior to offering to buy-back capacity from the Astaris and
19 from the Irrigation Pumpers:

20 Idaho Power's Risk Management Committee, in the face of
21 extremely high market prices this winter, chose to plan on a
22 monthly basis and rely solely on market purchases up until mid-
23 December 2000. The Committee did not begin considering other
24 options to mitigate the effects of high prices until mid-January, and
25 did not take any serious action until the beginning of February.
26 Staff believes that there were numerous signals that should have

1 caused the Company to act sooner. While most of the current
2 programs and actions of Idaho Power are probably appropriate,
3 they were late in coming.

4 Building on Staff's thoughts, here are some questions the Commission may want
5 to address if it considers whether Idaho Power performed prudently in making this
6 acquisition:

7 ✍ Did the Company act quickly enough once the implications of its
8 capacity constraints were understood so that it had time to weigh
9 options in addition to the Astaris and Irrigators contracts?

10 ✍ Should the Company have conducted a formal or informal competitive
11 bid to ascertain the "market price" for buy-back capacity before
12 making an offer to Astaris?

13 ✍ How effectively did Idaho Power Company negotiate with Astaris?

14 ✍ How effective were the Company's forecasting efforts in estimating
15 future load, available resources and the forward prices of power in the
16 market?

17 **Q. What other options should the Commission consider?**

18 A. The Commission may want to consider phasing in cost recovery of the Astaris
19 and Irrigators buy-backs through the PCA over a longer period than is now contemplated.
20 In other words, the Commission could defer a portion of the recovery of the expense (also
21 considering whether to grant Idaho Power a carrying charge) for an additional period of
22 time.

23 There is a direct justification (and precedence) for collecting such costs over a
24 longer period of time. If the Commission believes that this event (the coincidence of low
25 water and high, volatile wholesale market prices) was extraordinary and not likely to
26 recur, it could view the costs in these two PCA periods much like other one-time events
27 faced by utilities from time to time: storm damage, catastrophic outage of a generating

1 plant, etc.

2 In fact, the Staff of the Commission supported the deferral of a portion of PCA
3 costs in Idaho Power Company's previous PCA application. Specifically, Staff proposed
4 that the Commission not pass through forecast increased purchase costs of \$45.8 million
5 in view of the size of the true-up adjustment. This adjustment had the effect of shifting
6 forecast increased costs forward one year when they would be included in the true-up for
7 the following PCA period. Staff also recommended that, if the Commission approved
8 increased greater than 20% through the PCA, those increases be spread over two years.

9 The advantage of this approach is that it normalizes somewhat the one-time effect
10 of the electric power price spike seen in 2000-2001. Of course, the risk is that a similar
11 event will occur in the future, in which case the deferred amount would be added to
12 higher purchase power costs in the future.

13 **Q. Do you have any additional recommendations for alternative actions by the**
14 **Commission?**

15 A. Yes, one additional recommendation. Instead of abrogating the contract, the
16 Commission should use this opportunity to review its preferences for the ingredients of
17 future capacity purchases and communicate guidelines to Idaho utilities. While no one
18 expects the coincidence of a severe drought and wildly fluctuating wholesale market
19 prices to return in the near future, it would be useful for the Commission to prepare for
20 the possibility.

21 As I suggested before, the Commission should not, as a general matter, substitute
22 its judgment for negotiators at the utility who do this for a living. On the other hand, the
23 Commission can signal to the utility in advance the considerations it will make in judging

1 the prudence of their future negotiations. The Commission's considerations might
2 include a requirement of competitive bidding, an indexed price, or a "market out" clause.
3 I would not necessarily endorse the last two features since, while they might arguably
4 protect the buyer, they would also have the effect of increasing the cost of the resource by
5 shifting risk to the seller. Of course, opinions on such matter differ and the issues are
6 certainly worthy of a full discussion.

7 **Q. Bottom line, should the Commission abrogate the buy-back contract?**

8 A. No. The Commission should deny Staff's petition. While the proposal by Staff is
9 undoubtedly intended to benefit ratepayers, it is ultimately short-sighted and its benefits
10 do not outweigh the negative effects of a decision to abrogate the contract. If the
11 Commission is concerned that the buy-back agreement was imprudent, the correct
12 regulatory course is to disallow the expense for ratemaking purposes, not attempt to inject
13 regulation on an after-the-fact basis into the negotiations of a third-party vendor contract.
14 Finally, if the Commission is concerned that the increase in the PCA is too great, it
15 should consider phasing-in recovery of these higher power costs over a longer period of
16 time than the one-year recovery period in the Power Cost Adjustment.

17 **Q. Does this conclude your testimony?**

18 A. Yes.