

EXHIBIT WRA____(KB-2)

DPU Skookumchuck Memo
in Docket No. 04-035-05

Memorandum

To: Public Service Commission

From: Division of Public Utilities
Irene Rees, Director

Energy Section
Judith Johnson, Energy Manager
Tom Peel, Technical Consultant

Date: April 6, 2004

Subject: In the Matter of the Application of PacifiCorp for Exempt Wholesale Generator or Qualified Facility Determinations Relating to the Skookumchuck Hydroelectric Plant - Docket No. 04-035-05

ISSUE:

On February 13, 2004, PacifiCorp filed an application with the Utah Public Service Commission (Commission) requesting that the Commission make specific findings that will allow the Skookumchuck Hydroelectric Plant to become an “eligible facility” under section 32 of the Public Utility Holding Company Act (PUHCA). The Commission must find that the sale will result in **consumer benefits**, is in the **public interest** and does **not violate Utah State law**. This finding by the state jurisdictions is necessary before the Federal Energy Regulatory Commission (FERC) can authorize the purchaser (Washington LLC) to operate the Hydroelectric Plant as either an Exempt Wholesale Generator (EWG) or a Qualified Facility (QF).

The reporting requirements of R746-401-3 (B), relating to the sale of utility assets, does not apply because the assets have an allocated book cost which is below the reporting thresholds described in the Commission’s rule. The sale of the Skookumchuck Project (which includes a dam and a small hydro generator) is therefore not subject to Commission approval.

RECOMMENDATION:

The Division recommends that the Commission find that the sale of Skookumchuck Hydroelectric Plant will result in **consumer benefits**, is in the **public interest** and does **not violate Utah State law**. Such a finding allows the Project to become an “eligible facility” under section 32 of PUCHA. Upon completion of the sale, Washington LLC can then pursue EWG or QF status from the FERC.

BACKGROUND:

The Skookumchuck Project includes a dam (earth-fill) and a hydroelectric generating plant located in the vicinity of Centralia, Washington, on property adjacent to the Centralia Power Plant. The dam was constructed in 1973 as a water storage and cooling facility for the Centralia Power Plant. In 1991, a small hydroelectric generating plant, with a capacity of approximately one megawatt, was constructed at the dam. PacifiCorp, with a 47.5% ownership interest, along with other owners, intends to sell and transfer to Washington LLC the assets that comprise the Skookumchuck Project.

Washington LLC is a Washington limited liability company and a direct wholly-owned subsidiary of TransAlta. TransAlta is an indirect owner of the Centralia Power Plant and Centralia Coal Mine which was purchased in 2000 from PacifiCorp and six other public and private owners (Owners). The Centralia Power Plant is operated as an EWG. The same Owners, which sold the Centralia Power Plant and Centralia Coal Mine, own the Skookumchuck Project.

Several years ago, a Flood Control Committee (Committee) organized by Lewis and Grays Harbor Counties, Washington, and the cities of Centralia, Chehalis and Aberdeen, Washington, was formed to purchase the Skookumchuck facilities as part of a flood control project. Because of periodic flooding problems, they wanted to raise the height of the dam. The Committee declared its intent to operate the facilities in a manner that would not be in conflict with the continued operation of the Centralia Steam Plant.

The Owners, therefore, withheld the Skookumchuck Project from the sale of the Centralia Steam Plant. When the Centralia Steam Plant sale was completed, on May 4, 2000, the parties entered into the Skookumchuck Dam Management Agreement.

The Committee, however, has been unable to secure governmental appropriations for the flood control project. Because of the events of 9/11 (2001), the top priority for federal funds was shifted towards homeland security. Also, the Committee indicated that it would not pay for any additional costs to bring the Skookumchuck Dam up to federal seismic standards, and would only be willing to pay approximately 1/3 of the net book value of the Project, an offer that the Owners are not willing to accept.

TransAlta has expressed a willingness to meet the stability/safety requirements that may be imposed on the Skookumchuck Dam. The dam is subject to FERC jurisdiction relative to safety issues. The reservoir was primarily constructed to ensure a water supply at the nearby Centralia Steam Plant. Absent the proposed Committee's flood control project, the Skookumchuck Project would have been sold and transferred along with the Centralia Steam Plant and Centralia Coal Mine in 2000.

For the Skookumchuck Hydroelectric Plant to qualify as an EWG or QF, Washington LLC must be engaged exclusively in the business of owning or operating an "eligible facility" and selling electric energy at wholesale.

If the costs of a generation facility were included in the rates of a regulated utility on October 24, 1992 (the date of enactment of section 32 of PUCHA), then in order for the facility to be considered an “eligible facility,” every state commission having jurisdiction over such rates must specifically determine that the sale (1) will **benefit consumers**, (2) is in the **public interest**, and (3) does **not violate State law**. Washington LLC cannot process its EWG or QF application with the FERC until all of the Company’s regulatory commissions have made the three findings required by section 32 of PUCHA.

The expected impact of the sale is to lower the Company’s future revenue requirement by removing the Skookumchuck Project from the Company’s rate base and revenue requirement. In addition, the sale transaction eliminates the risk that PacifiCorp will be required to fund its share of expenditures for ensuring the structural integrity of the Skookumchuck Dam.

The expected present value (based on 30 years) of the future reduction in Utah revenue requirement for the Skookumchuck Project is approximately \$4.8 million. The unit cost of generation for the hydro facility is **not cost competitive**, currently about \$250 Mwh compared to a current market price in the \$40 - 50 Mwh range. The Skookumchuck Hydroelectric Plant is a small 1 MW hydro generation asset. The energy output is insignificant in the Company’s generation portfolio. Over the last four years generator output has been limited to about 1,000 Mwh/year, primarily as a result of circuit board failure in the control and communications module. The hydro facility is currently being operated in a manual mode when the part-time project operator is on site.

Generation output has always been sold to Puget who is paying \$0.016 cents/Kwh. The cost to generate is about \$0.25 cents/Kwh which produces a net loss of approximately \$0.23 cents/Kwh.

The Division believes that the sale of the Skookumchuck Dam along with the Hydroelectric Plant will benefit Utah consumers by lowering future revenue requirements and by eliminating the potential risk associated with the structural integrity of the dam. Therefore, the sale of the dam and the hydro facility is in the public interest and does not violate Utah State law.

The entire Skookumchuck Project is being **sold for book value**. The base sale price is \$7,570,373.16 (PacifiCorp’s share is approximately \$3,557,801). The final sale price will be adjusted for changes in net book value up to the Closing Date of the transaction. Based on its 47.5% share ownership, PacifiCorp is estimating a **loss** of \$68,613 from the sale transaction. The estimated loss results from netting PacifiCorp’s share of the Cost of Sale and income tax effects.

As of this date, the Wyoming and Washington Commissions have approved PacifiCorp’s application. The regulatory staffs of Idaho and California have recommended that their respective Commissions also approve the request.

cc: Committee of Consumer Services, Cheryle Murray
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