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June 26, 2006

***Via Hand Delivery***

Jean Jewell, Secretary  
Idaho Public Utilities Commission  
472 W. Washington St.  
Boise, Idaho 83720

Re: Case No. IPC-E-05-34

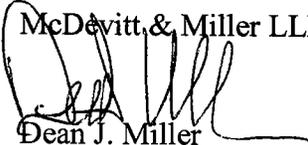
Dear Ms. Jewell:

Enclosed for filing in the above matter please find the original and seven (7) copies of Comments of Magic Wind, LLC.

An additional copy of the document and this letter is included for return to me with your file stamp thereon.

Very Truly Yours,

McDevitt & Miller LLP

  
Dean J. Miller

DJM/hh  
Encl.

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2006 JUN 21 PM 1:21  
PUBLIC UTILITIES COMMISSION

*Attorneys for Magic Wind LLC*

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE PETITION OF  
MAGIC WIND LLC TO DETERMINE  
EXEMPTION STATUS  
(Corrected Caption)

Case No. IPC-E-05-34

COMMENTS OF MAGIC WIND  
LLC

COMES NOW Magic Wind LLC (Magic Wind), by and through its counsel of record,  
and in response to the Commission’s Notice of Petition, dated June 2, 2006, submits the  
following Comments:

**Introduction and Background**

In this Motion for Declaratory Order (Motion), Magic Wind asks the Commission to  
approve an alternative method for determining the reduction in price paid to a wind project when  
generation from the project falls outside the “90-110 performance band”. As discussed in more  
detail below, Magic Wind refers to this alternative method as the “Modified PacifiCorp  
Method.”

As the Commission recalls, the 90-110 performance band grew out of Case No. IPC-E-  
04-08, *U.S. Geothermal v. Idaho Power Company*. In Final Order No. 29632, the Commission

determined that when the QF fails to deliver 90% of the monthly commitment amount all delivered energy should be priced at 85% of market price or the contract price, which ever is less (“Market Method”).

In the intervening time since issuance of Order No. 29632 (November, 2004), the Market Method has proved troublesome to project developers. Some financial institutions and other capital sources, all of whom put a value on predictability of potential liability, have worried that the relative unpredictability of future market prices creates a risk that is difficult to quantify, thus making their investment less certain of recovery. Others have worried that a reduction of market price by a seemingly arbitrary fifteen percent (15%) results in payments of less than avoided costs, in violation of PURPA.

As a result, project developers and some utilities, have explored options to the Market Method which would honor the spirit and intent of the 90-110 performance band, but would reduce the uncertainty inherent in the Market Method and would result in payments more consistent with the full avoided cost concept. The first such effort was in Case No. PAC-E-05-9, *Application of PacifiCorp for Approval of Power Purchase Agreement with Schwindeman Wind LLC*, filed August 15, 2005. Initially, PacifiCorp and Schwindeman proposed an alternative to the 90-110 performance band known as the Mechanical Availability Guarantee (MAG). The Commission, however, concluded that the MAG proposal was not comparably rigorous to the 90-110 performance band, and rejected it. (*See* Order No. 29880, dated October 4, 2005).

PacifiCorp and Schwindeman then explored options that would retain the 90-110 performance band, but decouple it from highly volatile market prices. The result was what is now referred to as the “PacifiCorp Method.” In contrast to the Market Method, the PacifiCorp Method computed a schedule of fixed rates to be paid for non-conforming energy as a substitute

for market-based rates. (See Joint Motion for Approval of Amended Agreement, Case No., PAC-05-09, dated January 27, 2006). The PacifiCorp Method produced prices reflecting an approximate 17 percent discount from published avoided costs. While the discount is substantial, it is predictable, in contrast to the Market Method.

The Commission Staff supported the PacifiCorp method and explained it this way:

“One way to rationalize the discount is to assume that a simple cycle combustion turbine would be used as a backup to a wind project whenever the wind project's generation could not be accurately predicted. One of the things a utility does not get if it accepts unpredictable energy from a wind project is dependable capacity. It is reasonable to assume that backup capacity to a wind project would be provided by a SCCT, the cheapest capacity available. The cost of capacity of a SCCT is equal to its capital cost and its fixed O&M cost. In addition, to the extent that the variable O&M costs for a SCCT are higher than for a CCCT, it is reasonable to assign those incremental costs as SCCT capacity costs.

The source for the capital and O&M costs of a SCCT is PacifiCorp's 2004 Integrated Resource Plan Update. The 2004 IRP was accepted by the Commission. Reference Case No. PAC- 05-2, Acceptance of Filing issued August 26, 2005. The 2004 IRP Update was submitted in 2005 by PacifiCorp to reflect significant changes in the Company's plan. However, while the Update was submitted, the Staff did not formally review the Update nor did the Commission issue an order accepting or acknowledging the Update. Nevertheless, Staff believes that the revised resource costs included in the Update are reasonable, and reflect the most up-to date costs available for a new SCCT resource in PacifiCorp's service territory.

Over time, the Non-Conforming Energy Prices could turn out to be higher or lower than market prices. Staff believes that the Non-Conforming Energy Prices are a reasonable proxy for Mid-C market index prices and represent a fair price to be paid for energy that cannot be delivered predictably. In addition, unlike market prices, they offer a fixed, known set of prices that will be paid over the life of the contract for energy delivered outside of the 90/110 percent performance band”. (See, *Staff Comments* dated March 8, 2006, Case No. PAC-E-05-9, pg 6—7).

While the PacifiCorp Method produced an end result that was acceptable to the parties for negotiation purposes, the method contained a technical flaw—it included variable O&M costs in the costs allocated to capacity value. These costs were based on a simple cycle

combustion turbine (SCCT). This defect was explained in the *Schwendiman* case in an informal filing by the Idaho Farm Energy Association and its consultant Dr. Don Reading:

“There is a theoretical flaw in PacifiCorp’s avoided cost calculation methodology. The Company includes variable O&M in the SCCT’s fixed costs. While this is consistent with the way PacifiCorp calculates avoided capacity prices in Utah and Oregon, it is simply incorrect. In economic terms, the task here is to determine the change in cost due to a change in demand (kW). Operating costs (kWh) are not part of this calculation. The change in variable O&M due to a change in kW is zero. There is no justification for treating variable O&M costs differently than variable fuel costs” (See Exhibit B to Motion for Declaratory Order, pg 7.).

The magnitude of error produced by including variable O&M costs in fixed cost varies, depending on the assumed capacity factor of the peaking resource. In the case of PacifiCorp the assumed capacity factor is 18%, while in the case of Idaho Power the assumed capacity factor is 59%. Accordingly, when applied to Idaho Power, the magnitude of error produced by the incorrect treatment of variable O&M costs in the PacifiCorp Method must be corrected.

In light of this, consultants for Magic Wind recalculated surplus energy prices for Idaho Power using the PacifiCorp Method, corrected for the proper treatment of variable O&M costs. Magic Wind now refers to this method as the Modified PacifiCorp Method. Attached to the Motion as Exhibit C are spreadsheets showing the calculation of surplus energy prices using the Modified PacifiCorp Method<sup>1</sup>.

On April 5, 2006 Magic Wind tendered to Idaho Power a proposed Firm Energy Sales Agreement containing prices for surplus energy calculated by the Modified PacifiCorp Method. Idaho Power has refused to execute a Firm Energy Sales Agreement that incorporates prices calculated by the Modified PacifiCorp Method, thus necessitating the filing of this Motion.

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<sup>1</sup> Electronic copies with formulas intact have been provided to Commission Staff and Idaho Power Company.

**The Commission should approve the Modified PacifiCorp Method as an Alternative to the Market Method**

In other aspects of administering the PURPA regulatory framework in Idaho, the Commission has made sensible mid-course adjustments as better knowledge is accumulated and as circumstances change. The Commission for example has adjusted its pricing methodologies as abilities to predict elements such as gas prices became more sophisticated. In short, the PURPA regulatory framework is not static regime. As circumstances change, regulatory policy can change.

So it is with the pricing methodology for energy falling outside the 90-110 performance band. As noted above, experience has shown that the Market Method produces an undue amount of uncertainty risk. And, the fifteen percent (15%) reduction to market price appears inconsistent with the avoided cost concept. A method, such as the Modified PacifiCorp Method, which calculates fixed prices based on capacity not delivered, eliminates this uncertainty risk, even though under some scenarios it produces price discounts greater than the Market Method. It is also more clearly faithful to the avoided cost concept.

Unlike the Market Method, the Modified PacifiCorp Method, is consistent with and is derived from the SAR avoided cost calculation methodology and the utility's Integrated Resource Plan. As can be seen from Exhibit C, accompanying the Motion for Declaratory Order, the Modified PacifiCorp Method starts with costs reported by Idaho Power in its 2004 IRP with respect to its Bennett Mountain SCCT. It is thus consistent with the current avoided cost methodology which bases avoided costs on a SCCT as the surrogated avoided resources. It accepts, without dispute, costs reported by Idaho Power Company. The method then develops prices for deliveries outside the 90-110 band, consistent with the theory that failure to deliver within the band is a failure to deliver capacity. Finally, the method takes into account the

seasonalization factors in Idaho Power's current avoided cost methodology. These prices are then transported as a schedule of fixed prices for each contract year into the Firm Energy Sales Agreement. (See, Exhibit A to Motion for Declaratory Order, paragraph 7.2).

Additionally, the Modified PacifiCorp Method provides an energy-only price for surplus energy deliveries. The concern about "lack of predictability" and "variability" identified by the Commission in *U.S. Geothermal* can also be stated as a concern that wind QF's may be less able to deliver promised capacity than other QF resources. A method that subtracts capacity price from total avoided costs to produce an energy-only price as the basis for pricing surplus energy is fully consistent with the intended effect of the 90-110 performance band.

**Idaho Power's Objection to the Modified PacifiCorp Method is Without Merit**

Idaho Power's objects to deviation from the Market Method on the grounds that "...elimination of market prices from consideration will shift costs and risks to customers that should appropriate be borne by Magic Wind and such shift is inconsistent with PURPA." (Idaho Power Answer to Motion for Declaratory Order, Dated May 8, 2006). Idaho Power advanced and explained in more detail this objection in Comments filed in the *Schwindeman* case. In response, PacifiCorp fully analyzed and refuted this contention. PacifiCorp's response to this contention is set forth below:

"PacifiCorp respectfully disagrees with IPC's contention that the pricing methodology for non-conforming energy contained in the power purchase agreement executed by PacifiCorp and Schwendiman Wind LLC ("Schwendiman PPA") shifts financial risk from the QF developer to PacifiCorp ratepayers, relative to IPC's pricing approach in its standard power purchase agreement ("PPA"). IPC correctly observes, in pages 4 and 5 of its comments, that in months when market prices (defined in the IPC PPA as 85% of non-firm Mid-C index price) are less than the PacifiCorp off-peak energy price (defined as PacifiCorp's published energy-only avoided cost price in Idaho), PacifiCorp customers will pay a QF more for non-conforming energy than they would have paid under the pricing methodology included in the IPC PPA. Conversely, when market prices are *higher* than PacifiCorp's off-peak energy price, its customers will pay less than they would under Idaho Power's approach. However, the conclusion IPC draws

from this difference-that its approach is better for utility customers-depends upon several subjective assumptions that cannot be substantiated or verified. For one matter, it is not always appropriate to assume that the market prices from the last several years are indicative of future market prices. One only has to look at the energy crisis of 2000-01 as a clear example of that. For another, IPC's conclusion assumes that the QF's behavior (e.g. scheduling algorithm and risk management strategies) will be identical under the two approaches-another unverifiable assumption. PacifiCorp believes (as Schwendiman has asserted to it) that Schwendiman's monthly delivery estimates will be more accurate under the Schwendiman PPA than they would be under the IPC PPA because the added risk from using indexed prices for non-conforming energy in the IPC PPA would cause Schwendiman to low-ball its estimates. In other words, fear of the unknown inherent in the IPC PPA could change Schwendiman's scheduling priority, from accurate prediction to under-prediction in order to avoid under-delivery price risk. For both reasons, PacifiCorp believes it is more accurate to say that its approach *changes* the allocation of risks associated with under-or over-deliveries compared to IPC's PPA; whether the net result of this difference favors PacifiCorp's customers or the QF, however, is unknowable. The important point, in PacifiCorp's opinion, is that its pricing methodology for non-conforming energy, like IPC's, gives the QF a strong incentive to accurately schedule its Net Output (regardless what market prices may be in the future) while limiting the maximum potential liability of the ratepayer." (Reply Comments of PacifiCorp, Case No. PAC-E-05-09, dated March 22, 2006).

Likewise, in the *Schwindeman* case, Commission Staff disagreed with Idaho Power and observed that prices derived by the PacifiCorp Method are, in themselves, a reasonable approximation of market prices:

"Over time, the Non-Conforming Energy Prices could turn out to be higher or lower than market prices. Staff believes that the Non-Conforming Energy Prices are a reasonable proxy for Mid-C market index prices and represent a fair price to be paid for energy that cannot be delivered predictably. In addition, unlike market prices, they offer a fixed, known set of prices that will be paid over the life of the contract for energy delivered outside of the 90/110 percent performance band." (See Staff Comments, Case No. PAC-E-05-09 dated March 8, 2006).

### **The Modified PacifiCorp Method is Superior to the PacifiCorp Method**

As discussed above, while the PacifiCorp Method produced prices acceptable in negotiations between the parties in *Schwindeman*, the method contains the theoretical flaw of including variable O&M costs in fixed costs which has the effect of reducing the price from non-conforming or surplus energy.

Dr. Reading's basic point—that in a pricing structure which includes both fixed and variable costs, fixed costs should be assigned to the fixed cost component of the price and variable costs to the variable cost component—is so obviously correct that further elaboration is not required.<sup>2</sup>

As explained by Dr. Reading, if not corrected, the flaw will produce a significant error in calculating surplus prices for Idaho Power Company:

“The size of the PacifiCorp error is determined by the capacity factor assumed for the SCCT. PacifiCorp uses an 18% capacity factor based on their 2004 IRP Update. If this error isn't corrected, it will have a far larger impact if the method is applied to Idaho Power. Idaho Power assumes an SCCT capacity factor of 59% in their 2004 IRP. For 2006, the PacifiCorp calculation reduces the Non conforming Energy Price by 1.86 \$/MWh. If applied to Idaho Power, the error will equal 2.80 \$/MWh.” (Exhibit B, pg. 8 of Motion for Declaratory Order).

The error in the PacifiCorp Method is not just a matter of theoretical purity. If applied to Idaho Power it would seriously distort the schedule for prices for non-conforming energy.

### **Conclusion**

For the reasons and authorities cited herein, Magic Wind respectfully requests that the Commission enter its order declaring and determining that Magic Wind is entitled to receive from Idaho Power Company a Firm Energy Sales Agreement that establishes for surplus energy using the Modified PacifiCorp Method.

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<sup>2</sup> In setting retail rates for public utilities there may be equitable reasons for departing from this principle, but in the context of the prices at issue here there is no reason—economic, equitable or otherwise—for departure from the principle.

DATED this 21 day of June, 2006.

MCDEVITT & MILLER LLP

A handwritten signature in black ink, appearing to read "Dean Miller", written over a horizontal line.

Dean J. Miller

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*Attorneys for Magic Wind LLC*

**CERTIFICATE OF SERVICE**

I hereby certify that on the 21<sup>st</sup> day of June, 2006, I caused to be served, via the method(s) indicated below, true and correct copies of the foregoing document, upon:

Barton L. Kline  
Idaho Power Company  
1221 West Idaho Street  
P.O. Box 70  
Boise, ID 83707  
BKline@idahopower.com

Hand Delivered   
U.S. Mail   
Fax   
Fed. Express   
Email

McDEVITT & MILLER LLP

BY Heather Houle, Legal Asst