

DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: SCOTT WOODBURY

DATE: MARCH 24, 2006

SUBJECT: CASE NO. PAC-E-05-9 (PacifiCorp)
AMENDED POWER PURCHASE AGREEMENT – SCHWENDIMAN
WIND LLC

On August 15, 2005, PacifiCorp dba Utah Power & Light Company (PacifiCorp; Company) filed an Application for approval of a Power Purchase Agreement (Agreement) for the sale and purchase of electric energy between PacifiCorp and Schwendiman Wind LLC (Schwendiman). On October 4, 2005, the Commission in Order No. 29880 rejected the filed Application because the submitted Agreement did not include a “90/110 percent performance band,” a provision that defines the minimum degree of predictability required for published rate eligibility. In its Order the Commission found that the 90/110 performance band established in Order No. 29632 or a similarly rigorous requirement is necessary to assure that PacifiCorp’s customers will receive the generation product they are paying for. Based on the established record, the Commission found the Agreement’s “mechanical availability guarantee” (MAG) to be an unacceptable substitute for the 90/110 performance band and one that failed to sufficiently protect ratepayers from overpaying. An agreement without such a provision, the Commission found, is neither reasonable nor in the public interest. The Commission provided the parties 14 days to submit an amended Agreement containing a 90/110 performance band. Pursuant to subsequent filings the deadline for filing an amended Agreement was continued.

Amended Agreement

On January 27, 2006, PacifiCorp and Schwendiman filed a Joint Motion with the Commission requesting approval of a 20-year amended Power Purchase Agreement (Amended

Agreement) dated January 27, 2006. Schwendiman proposes to design, construct, install, own, operate and maintain a wind generating facility with a nameplate capacity of 20 MW to be located in Bonneville County, Idaho. Pursuant to the Amended Agreement, Schwendiman will sell and PacifiCorp will purchase approximately 7.15 aMW of electric energy generated by the Schwendiman wind facility, a qualified small power production facility (QF) under the Public Utility Regulatory Policies Act of 1978 (PURPA).

Amended Agreement Paragraph 2.1 conditions the Amended Agreement's effectiveness upon a Commission determination that the prices to be paid for energy and capacity are just and reasonable, in the public interest, and that the costs incurred by PacifiCorp for purchasing capacity and energy from Schwendiman are legitimate expenses, all of which the Commission will allow PacifiCorp to recover in rates in Idaho in the event other jurisdictions deny recovery of their proportional share of said expenses. Schwendiman's commercial operation date is scheduled to occur by July 31, 2007.

Delivery of Energy and Capacity

Pursuant to Amended Agreement, PacifiCorp will purchase the net output of 7.15 aMW from the eight 2.5 MW Clipper wind generators comprising the QF. In accordance with Section 4 of the Amended Agreement, Schwendiman will be required to achieve an actual monthly capacity factor within 10% of its forecasted monthly capacity factor (bandwidth). In the event Schwendiman is outside the bandwidth, then it will receive the energy-only price (capacity component removed) for all non-conforming energy delivered during that month.

Under Paragraphs 2.3 and 10.4 of the Amended Agreement, Schwendiman will reimburse PacifiCorp's costs for obtaining replacement power if Schwendiman misses the scheduled commercial operation date of the plant (up to 120 days), or PacifiCorp terminates the Agreement in the event of a seller default (up to 12 months). The replacement power price is the average of the Mid-C and Palo Verde firm market price over the defined period of reimbursement. Schwendiman would be responsible for the positive difference, if any, between the contract price and the replacement power price for the volume of replacement energy.

Swendiman will not be compensated for delivering more than 10 aMW in any given month. As described in Paragraph 5.4 of the Amended Agreement, if the facility delivers more than 10 aMW on a monthly basis, PacifiCorp will accept the energy but will not purchase or pay for the portion delivered in excess of 10 aMW.

Purchase Price

The contract purchase price to be paid Schwendiman for its wind generation are Idaho's published non-levelized avoided cost rates, as currently established by the Commission in Order No. 29646 for QFs that deliver less than 10 aMW on a monthly basis. The Schwendiman facility is expected to have net generation of approximately 62,700 MW hours annually. Thus, PacifiCorp's average annual energy purchase obligation over the term of the Amended Agreement will be approximately \$4 million, with a total nominal cost of \$72.7 million. All applicable interconnection charges and monthly operation and maintenance charges under the generation interconnection agreement with PacifiCorp transmission will be assessed to Schwendiman.

Changes to Original Agreement

As reflected in the Joint Motion description of changes to the original Agreement, the Amended Agreement contemplates an estimated annual sale and purchase of 62,723,088 kW hours compared to the 54,882,702 kW hours contemplated in the original Agreement. The difference arises because Schwendiman proposes to add an additional turbine to the facility thereby increasing its nameplate capacity from 17.5 MW to 20.0 MW.

The Amended Agreement omits provisions related to guaranteed mechanical availability. Consequently, provisions related to seller's minimum availability obligations in Sections 4 and 5 of the original Agreement have been deleted, as have the defined terms "Availability," "Cut-in Speed," "Minimum Availability Obligation," "Output Shortfall," and "Sufficient Wind."

The Amended Agreement adds the term "Non-Conforming Energy" to describe energy delivered in excess or deficit of the seller's monthly delivery obligation. As required by Order No. 29880 the Amended Agreement requires seller to deliver between 90% and 110% of its scheduled delivery on a monthly basis and provides that seller receive the energy only price for all Non-Conforming Energy. These provisions are added to Sections 4 and 5 of the Amended Agreement.

The Amended Agreement measures monthly performance using a Monthly Capacity Factor. The Monthly Capacity Factor is subject to adjustment for periods of excusable non-delivery, using a process purportedly analogous to the adjustment process contained in Commission approved Power Purchase Agreements filed by Idaho Power Company.

In Section 6.4, the Amended Agreement clarifies the formula for calculating PacifiCorp's liquidated damages in the event of termination due to seller's default.

The Amended Agreement revises the construction milestones in Section 2.2, postponing the Scheduled Commercial Operation Date from July 15, 2006 in the original Agreement to July 31, 2007 in the Amended Agreement. The cap on seller's potential liability for daily delay damages, to be assessed in the event of unexcused delay in Commercial Operation, has been extended from 90 days to 120 days.

In Order No. 29880 (pp. 11, 12), the Commission stated that an acceptable published avoided cost Power Purchase Contract should: (1) measure QF production on a monthly basis; (2) differentiate the price paid for energy based on its reliability and predictability; and (3) provide a similarly rigorous and reasonable equivalent to the 90/110 performance band established in Order No. 29632. PacifiCorp and Schwendiman contend that the Amended Agreement addresses all three of these concerns.

Grandfathering Treatment

In Order No. 29880, the Commission found that the "grandfathering" provisions set forth in Order No. 29839 did not apply to the Application in Case No. PAC-E-05-9 because the original Agreement was signed and dated July 19, 2005 – well before the August 4, 2005 effective date that reduced eligibility for PURPA contract rates from 10 aMW to 100 kW. PacifiCorp and Schwendiman assert that the Amended Agreement should be accorded similar grandfathering treatment because the Schwendiman project was sufficiently mature at the time of Order No. 29839 and thus entitled to published rates. Additionally, the contract parties contend that the Amended Agreement, which was negotiated to meet the Commission's objections to the original Agreement, may properly be viewed as an extension of the original Agreement and it should therefore be subject to the same rules as the original Agreement.

On February 8, 2006, the Commission issued Notices of Filing and Modified Procedure in Case No. PAC-E-05-9. The deadline for filing written comments regarding the Amended Power Purchase Agreement and related Joint Motion was March 8, 2006. Timely comments were filed by Commission Staff, Idaho Power Company, and a number of interested parties including the Idaho Farm Energy Association. Reply comments were subsequently filed by both PacifiCorp and Schwendiman. Disapproval of the Agreement was recommended by

only one party, an individual in Idaho Falls who believes that the proposed wind farm is not a profitable venture and that the Commission and PacifiCorp should wait to see whether the Wolverine Creek Energy LLC project proves to be successful. The remaining comments can be summarized as follows:

Commission Staff

Staff contends that the Amended Agreement prices to be paid for energy and capacity are just and reasonable, in the public interest, and that the cost incurred by PacifiCorp for purchasing capacity and energy from Schwendiman are legitimate expenses. Staff recommends that the Amended Agreement be approved.

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. Staff does not view the non-conforming energy prices in the Agreement as necessarily establishing a precedent to be followed in other contracts. Staff does believe, however, that the approach used here could provide a reasonable alternative for future wind contracts for PacifiCorp, Idaho Power and Avista.

The Amended Agreement clarifies a formula for calculating liquidated damages in the event of termination due to sellers default. Staff notes that the Commission has never adopted rules requiring payment of liquidated damages for small QF projects that are delayed or failed to materialize. However, Staff states that it is not opposed to such provisions and believes they should be permitted.

The Amended Agreement in addition requires Schwendiman to meet monthly estimates of capacity factor rather than monthly estimates of generation. Because monthly capacity factor and monthly energy generation are mathematical derivations of each other, Staff believes that the change is not material.

Idaho Power Company

Idaho Power in its comments contends that the procedure for computing “liquidated damages” contained in the Amended Schwendiman Agreement has a greater tendency (when market prices are lower than the fixed price) to shift the costs of QF non-performance away from QF developers and onto utility customers than does the market-based liquidated damage provisions contained in the multiple QF contracts the Commission has approved for Idaho Power. Idaho Power does not object to PacifiCorp seeking approval of a QF contract that

includes terms and conditions that are different from those that the Commission has approved for Idaho Power QF contracts so long as Idaho Power is not required to include Schwendiman terms and conditions in existing or future Idaho Power QF contracts. Idaho Power recognizes that PacifiCorp operates in several jurisdictions and desires to utilize a pricing structure for liquidated damages in its QF contracts that provide state-to-state uniformity. Idaho Power notes with concern that since the filing of the Schwendiman Agreement, QF developers have represented to the Company that if the terms in Schwendiman are found to be reasonable that they believe they are entitled to the same terms under an Idaho Power contract.

Idaho Power believes that its liquidated damages provision and its 90%/110% performance band are somewhat more rigorous than the equivalent provisions in the Schwendiman Agreement. Idaho Power requests that the Commission confirm that the 90/110 performance band and liquidated damage provisions for generation outside that band that the Commission has approved in multiple Idaho Power QF contracts is fair, just and reasonable, and that Idaho Power can continue to utilize that pricing arrangement in its contracts with QF developers seeking to sell QF power to Idaho Power.

Idaho Farm Energy Association

The Idaho Farm Energy Association (IFEA) supports approval of the Schwendiman Amended Agreement and views its modified 90/110 banding mechanism as a significant improvement over the prior version of the band. IFEA contends, however, that the methodology used to separate the capacity and energy price components in the Amended Agreement contain an important error which must be corrected if these new contract terms are to be applied to other projects. In addition the Association believes that the 90/110 performance band remains an unjustified reduction from full avoided cost prices. It also objects to the failure of the methodology to recognize that deliveries below the 90% band still have capacity value. Rather than persisting with the 90/110 banding requirement, IFEA believes that all parties would be better served by requiring that wind projects provide forecasts from pre-approved advanced forecasting services.

The “non-conforming energy” price set forth in the Schwendiman Amended Agreement is too low, IFEA contends, because it fails to include the full value of variable operations and maintenance costs for the Surrogate Avoided Resource. A portion of variable O&M costs, it states, were included in the capacity component of the published rates, which has

the effect of reducing the energy component, and thus the non-conforming energy price. IFEA's analysis is set forth in its comments together with the supporting analysis of its consulting economist, Don C. Reading of Ben Johnson Associates, Inc.

Dr. Reading states in his analysis:

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.

In both Oregon and Utah, the avoided capacity price is simply used to allocate total avoided costs between time periods. Therefore PacifiCorp's methodology does not reduce total avoided costs. It only shifts a minor amount of avoided costs between on-peak and off-peak periods. In the Schwendiman case, this flawed methodology reduces the price of Non-Conforming Energy. Therefore, it causes an unfair loss to the projects that will be subject to this approach.

Other Comments

Other commenting parties offer criticism of the underlying 90/110 banding requirement. It is not, one states, an assurance of better forecasting or an incentive for performing and delivering power. Trying to provide an accurate wind forecast, a professor of mechanical engineering states, is difficult, if not impossible, beyond 48 to 72 hours. For a forecast three months in advance, the best approach is to use statistical data and statistical averages – but such data is influenced by phenomena such as El Nino and climate change dynamics. A better system, another contends, is one that incorporates day-ahead and hour-ahead forecasting for wind power production. It is those timeframes, he contends, that are most important for operation and balancing of generation and the power grid. If the 90/110 banding is retained, it is recommended by a commenter that a larger error band be considered or that the financial incentives be changed.

PacifiCorp Reply Comments

PacifiCorp in reply comments disagrees with Idaho Power's contention that the pricing methodology for non-conforming energy (in the Schwendiman PPA) shifts financial risk

from the QF developer to PacifiCorp ratepayers. PacifiCorp's non-conforming energy price is based upon removing the fixed capital and fixed O&M costs for a SCCT from the total avoided cost price as computed using the Commission-approved SAR methodology. This modification to the SAR methodology, PacifiCorp contends, is a prudent and reasonable approach to determine the energy-only price to be paid for non-conforming energy. PacifiCorp states that Idaho Power's conclusion that its market-based pricing approach for non-conforming energy is better for customers is based upon several subjective assumptions that cannot be substantiated or verified.

1. It is not always appropriate, PacifiCorp contends, to assume that the market prices from the last several years are indicative of future market prices. E.g., energy crisis of 2000-2001.
2. Idaho Power's conclusion also 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 that Schwendiman's monthly delivery estimates will be more accurate under the Schwendiman PPA, because the added risk for using index prices for non-conforming energy in the Idaho Power PPA would cause Schwendiman to low-ball estimates 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 Idaho Power's PPA; whether the net result of this difference favors PacifiCorp's or the QF, however, PacifiCorp states, is unknowable. In PacifiCorp's opinion, the important point is that its pricing methodology for non-conforming energy, like Idaho Power's, gives the QF a strong incentive to accurately schedule its net output while limiting the maximum potential liability of the ratepayer.

While Commission Order No. 29880 makes clear that an Idaho electric utility must include the 90/110 performance or similarly rigorous requirement in its standard contract, the Order, PacifiCorp notes, does not require that non-conforming energy must be priced based upon a market index.

PacifiCorp also objects to Idaho Power's characterization of the non-conforming energy price as "liquidated damages." PacifiCorp believes a more accurate term is "non-conforming energy price adjustment." The reduced payments for non-conforming energy, PacifiCorp contends, are intended to reflect the lesser value of the energy delivered, not a

monetary sum for breach of contract that a contracting party agrees to pay. PacifiCorp and Schwendiman both understand, PacifiCorp contends, that deliveries outside the 90/110 band are not a breach of the Agreement.

Regarding IFEA's comments, PacifiCorp recommends that the Commission acknowledge that IFEA "supports approval of the Schwendimen Amended Agreement" and ignore the remainder of its comments regarding variable O&M and critique of the 90/110 band as beyond the scope of this proceeding.

Schwendiman Reply Comments

Schwendiman by way of reply makes clear that it seeks no modification of the Amended Agreement's pricing terms. Schwendiman notes that in its negotiations with PacifiCorp it was well aware of the variable O&M issue discussed in the IFEA comments. Should the issue need further study with respect to other contracts in the future, Schwendiman contends that it should not be done in the context of this contract approval proceeding.

Regarding Idaho Power's comments contrasting the two pricing methods, Schwendiman contends that the future energy price being unknown, the ratepayer is equally likely to benefit from either PacifiCorp and Idaho Power's band mechanism. Schwendiman, as did PacifiCorp, also objects to Idaho Power's characterization of the payments for energy delivered outside the 90/110 band as liquidated damages. The phrase "liquidated damages," Schwendiman contends, necessarily implies a breach of contract. Deliveries outside the 90/110 band are not a breach, Schwendiman maintains. The reduced payments are rather intended to reflect a lesser value of the energy delivered.

COMMISSION DECISION

Tendered for Commission consideration is an Amended Power Purchase Agreement between Schwendiman and PacifiCorp. Does the Commission find it reasonable to approve the Agreement as submitted? Does the Commission wish to address any of the collateral issues raised by other commenting parties?

Scott D. Woodbury

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