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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE PETITION OF US MAGNESIUM LLC FOR APPROVAL OF A CONTRACT FOR THE SALE OF CAPACITY AND ENERGY FROM ITS EXISTING AND PROPOSED QF FACILITIES	DOCKET NO. 03-035-38 **PETITION**

Pursuant to Utah Code Ann. § 54-12-2, as well as Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §824a-3, US Magnesium LLC ("US Magnesium") hereby petitions the Commission to approve a contract for the sale to PacifiCorp of electric energy and capacity from US Magnesium's existing and proposed expanded Qualifying Facility following expiration of its existing contract on December 31, 2004. US Magnesium submits that its proposed contract attached hereto as Exhibit "A" should be approved, subject to such additions, changes or amendments as may be appropriate, lawful and in the public interest.

In support of this Petition, US Magnesium states as follows:

1. This Commission has jurisdiction over this Petition pursuant to Utah Code Ann. § 54-12-1, et seq., as well as Section 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), 16 U.S.C. § 824a-3, and regulations promulgated thereunder.

2. US Magnesium operates magnesium production facilities near Rowley, Utah. US Magnesium currently operates an electric generation facility capable of generating approximately 35 MW of capacity that is a Cogeneration Facility under Utah law and a Qualifying Facility under PURPA ("QF"). US Magnesium is in the process of upgrading its facilities in order to become more efficient and to increase output. US Magnesium is also in negotiations with Desert Power LP ("Desert Power") for the use of thermal energy from its contiguous generation facilities. It is US Magnesium's expectation that Desert Power will become a QF and will file a separate petition for approval of a contract for the sale of the output of its resource to PacifiCorp. Collectively, the qualifying facilities of US Magnesium and Desert Power will provide nearly 150 MW of QF generation to PacifiCorp.

3. US Magnesium's predecessor in interest, Magnesium Corporation of America ("Magcorp"), filed a petition before this Commission in January 2002 to require PacifiCorp to purchase the output of its existing QF facility at avoided cost rates. Magcorp was unable to persuade PacifiCorp to offer full avoided cost rates as required by law. Magcorp ultimately accepted a short-term settlement with payments based on short-term firm market prices, rather than full avoided costs.

4. Under applicable federal and state laws, PacifiCorp is required to purchase all power and energy offered to it by a QF at PacifiCorp's avoided costs. US Magnesium is ready, able and willing, and is offering, to sell power and energy from its QF to PacifiCorp at the avoided cost rates and terms specified in the attached contract following the expiration of its current contract.

5. PacifiCorp has failed and refused to offer rates equivalent to its avoided costs or to provide indicative pricing for the upgraded facilities that are reasonably reflective of its

avoided costs. PacifiCorp has failed to provide a proposed contract or legitimate avoided cost prices despite the fact that it is proceeding with all due haste to construct new facilities of its own at prices believed to be substantially in excess of the so-called "avoided costs" that it is offering to US Magnesium.

6. Both the US Magnesium QF facility and the Desert Power QF facility are substantially in place and will require only minor upgrades to reach a combined capacity level of approximately 150 MW. The US Magnesium QF has three existing turbines with an approximate output of 36 MW. In connection with the upgrade, the turbines will be rebuilt and upgraded to provide 46.8 MW. The existing Desert Power generation consists of 2 turbines with a capacity of 65 MW. Following a proposed upgrade to a combined cycle system, the capacity of the Desert Power facility will be increased to approximately 100 MW.

7. US Magnesium and Desert Power have been attempting to work through the cumbersome process of obtaining a QF contract from PacifiCorp for over a year. QF contracts typically must be in place in advance so that the economics can be demonstrated for purposes of obtaining financing needed to invest in the upgrades. Moreover, US Magnesium and Desert Power have been forced to propose the size for their facility upgrades without any clear understanding of the optimal economic size for PacifiCorp; with appropriate pricing signals the upgraded facilities could be much larger. Certain entities have proposed to construct much larger QF facilities at the US Magnesium site, but without a known economic basis to justify the increased infrastructure that would be required, anything beyond the least costly upgrade option creates considerable risk. Due to PacifiCorp's persistent refusal to provide reasonable information to US Magnesium, it is left with little choice but to scale its project back to a more moderate level and to petition the Commission to approve the contractual terms submitted

herewith.

8. The process for obtaining a QF contract from PacifiCorp for a facility larger than 1 MW is extremely cumbersome and has taken an extraordinary amount of time. In early 2002, US Magnesium asked this Commission to adopt a procedure for a larger QF to obtain avoided cost pricing, rather than being left to negotiate with PacifiCorp or file proceedings with the Commission, which led to the adoption by this Commission of Schedule 38. In accordance with proposed guidelines for Schedule 38, which were later adopted by this Commission, US Magnesium made a request in November 2002 for "indicative pricing." Proposed prices were finally provided by PacifiCorp in February of 2003, but they were unreasonably low and inadequately documented or explained. In May of 2003, US Magnesium learned that PacifiCorp's proposed prices did not include any credit for capacity deferral because PacifiCorp was applying a 100 MW minimum threshold for a capacity credit

9. US Magnesium has been struggling in vain for many months to understand PacifiCorp's calculations and to obtain reasonable prices for its QF power and energy. On February 24, 2003, in Docket 02-035-T11, the Commission ordered PacifiCorp to file a methodology to develop avoided costs within ninety days. On September 24, 2003, the Commission ordered PacifiCorp in Docket 03-035-14, to file a revised avoided cost methodology within sixty days. To date, PacifiCorp has failed to make a filing with an appropriate or workable avoided cost methodology or to provide any specific answers as to how it proposes to calculate capacity payments. Moreover, despite several QF working group meetings to discuss capacity payments, no resolution has been reached as to a proper methodology for determining capacity payments for a QF. As a result of PacifiCorp's actions and inactions, the Schedule 38 process has failed to produce the intended results and US

Magnesium is left to petition the Commission to approve appropriate avoided cost rates.

10. PacifiCorp proposes to calculate capacity payments through the use of its IRP model. This approach, however, has proved to be extremely problematic and unworkable. The IRP model was created to help develop long-term least-cost resource development plans, but it cannot be used by project developers to determine or confirm reasonable avoided costs projections. PacifiCorp refuses to make its model or certain critical input data available to QF developers, and instead provides only “black box” outputs that are confusing, unverifiable and unbelievable. The IRP planning model cannot be used to calculate reasonable avoided cost rates.

11. PacifiCorp’s “black box” methodology for developing avoided costs rates is unacceptable, and likely unlawful.[1] By limiting access to data and models, only PacifiCorp can reasonably control or determine the myriad of assumptions and inputs that affect the outcome. Moreover, the IRP methodology provides inconsistent and illogical avoided cost results. A QF pricing methodology should be relatively simple and should use calculations that are transparent, verifiable and logical. US Magnesium proposes with this filing the adoption of a process that will allow avoided costs to be determined without endless delay and obfuscation.

12. US Magnesium proposes to use a “Next Deferrable Plant” (“NDP”) approach as the basis for establishing avoided cost rates. Moreover, US Magnesium proposes to use PacifiCorp’s West Valley lease with its affiliate as the NDP, since that lease can be terminated by PacifiCorp in 2006. The West Valley plant also provides clear operating data from which specific operating costs can be developed.

13. Under the contract submitted herewith, PacifiCorp will pay US Magnesium monthly for deliveries from the facility at a price that includes a fixed capacity payment derived

[1] US Magnesium is currently exploring the legality of PacifiCorp’s actions and inactions in relation to its QF project with the Federal Energy Regulatory Commission.

from PacifiCorp's current lease agreement for the West Valley units, and fixed and variable operation and maintenance costs derived from PacifiCorp's actual operating costs for those units. It is the intent of the Agreement that the purchase price paid by PacifiCorp during the first year will be based upon the fixed and variable costs actually incurred by PacifiCorp in connection with the West Valley units for the twelve month period ending December 31, 2003, the actual heat rate of the West Valley units, actual fuel costs as they are incurred in the future, and PacifiCorp's ability to schedule the US Magnesium facility as though it were a West Valley Unit. After the first year, the fixed and variable components will be adjusted based upon inflation. For capacity and energy provided by the QF facility when PacifiCorp does not schedule it, the price will be based upon the lower of the West Valley-based costs or firm or non-firm market prices, depending upon PacifiCorp's resource balance at the time. The specific costs, pricing factors and formulae used to calculate the monthly purchase price are detailed in Exhibit D to the contract.

14. QF rights provided by Section 210 of the Public Utility Regulatory Policy Act (PURPA) and Utah Code Sections 54-12-1 and 54-12-2 are intended to encourage the development of more efficient technologies and to encourage the greatest amount of energy utilization per unit of resource input. The need to promote the most efficient use of valuable resources is vitally important in today's environment. A regulated utility, however, has little incentive to develop complicated synergies to use thermal energy from power plant exhaust as a QF must do. Rather, a utility has the incentive to invest as much in rate base as possible in order to generate returns for shareholders. Not surprisingly, the utility is thus the regular "winner" of its own RFP processes and it regularly submits proposed plant additions to the Commission for approval on an expedited and emergency basis. QF facilities cannot afford to compete in an

arduous, expensive and predictable RFP process, where even losing bids can cost hundreds of thousands of dollars. Utilities have every incentive to keep all competitors out of "their" business.

15. Energy-intensive businesses must constantly find the most efficient manner to produce products in ever-increasingly competitive world markets. If local jobs are to be maintained, increased efficiency must be extracted from existing production processes. QF laws present one important means of helping industrial processes to increase efficiency, maintain competitiveness and retain Utah jobs, while also benefiting utility ratepayers.

16. Even beyond PacifiCorp's legal obligation to purchase QF resources, the QF resources proposed by US Magnesium, as well as the resources proposed by Desert Power, are in the public interest. They are capable of providing partial relief to the pressing need for new generation resources within PacifiCorp's transmission constrained "bubble." Moreover, the capacity offered by these resources, along with other available resources, will provide the Commission and the parties with sufficient additional time to allow a thorough and full investigation concerning PacifiCorp's RFP process and the requested certificate of convenience and necessity for the Current Creek project in Docket 03-035-29.

17. US Magnesium respectfully requests that its proposed contract be approved as quickly as possible, following appropriate analysis by regulators, so that its facilities can be timely upgraded in an effort to permit it to become more competitive and retain its significant contributions to the Utah economy.

18. In making this filing, US Magnesium intends legally to obligate itself to the delivery of energy and capacity from its facility at rates reflecting PacifiCorp's current full avoided costs, and to create a legally enforceable obligation between the Parties. The U.S.

Magnesium project is mature, US Magnesium has attempted in good faith, but failed, to negotiate a contract with PacifiCorp, and US Magnesium would have a contact in place but for the conduct of PacifiCorp. [*See* 18 C.F.R. §§ 292.303(a), 292.304(d)(2); *Rosebud Enterprises, Inc. v. Idaho Public Utilities Commission,* 951 P.2d 521, 525-26 (Idaho 1998); *Armco Advanced Materials Corp. v. Pennsylvania Public Utility Commission*, 579 A.2d 1337, 1347 (Pa. Cmwlth. 1990), *aff'd per curiam*, 634 A .2d 207 (Pa. 1993), *cert. denied sub nom.*, *West Penn Power Co v. Pennsylvania Public Utility Commission*, 513 US 925 (1994)].

19. In support of this Petition, US Magnesium submits herewith the testimony of Roger Swenson, an energy consultant for US Magnesium and Desert Power, along with its proposed QF contract for approval. Mr. Swenson's testimony describes his proposal for a workable and equitable methodology for calculating avoided costs.

US Magnesium respectfully petitions this Commission to enter an order approving a contract requiring PacifiCorp to purchase all power and energy offered to it from US Magnesium's QF beginning January 1, 2005, under terms and avoided cost rates specified therein. In order to meet the projected December 1, 2005 start date, US Magnesium respectfully requests approval of the contract submitted herewith by February 28, 2003.

DATED this 5th day of December, 2003

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was mailed, postage prepaid, this 5th day of December, 2003, to the following

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