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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF US MAGNESIUM LLC FOR APPROVAL OF A QF CONTRACT	Docket No. 03-035-38

PREFILED SUPPLEMNTAL TESTIMONY OF ROGER J. SWENSON

US Magnesium LLC hereby submits the Supplemental Testimony of Roger J. Swenson in Docket 03-035-38.

DATED this 15th day of November, 2004.

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Gary A. Dodge,
Attorney for US Magnesium LLC

PREFILED SUPPLEMENTAL TESTIMONY

Of

ROGER J. SWENSON

On behalf of US Magnesium LLC

IN THE MATTER OF THE APPLICATION OF US MAGNESIUM LLC FOR APPROVAL OF A QUALIFYING FACILITY CONTRACT FOR THE SALE OF POWER TO PACIFICORP

Docket No. 03-035-38

November 15, 2004

Q. What is the purpose of this supplemental testimony?

A. US Mag's original petition in this docket, filed in December 2003, sought pricing and terms for a long-term firm QF arrangement and attached a proposed firm QF contract submitted for approval. Since that time, US Mag has participated extensively with others in reaching a comprehensive stipulation ("QF Stipulation") in the large QF pricing docket, 03-035-14, and has engaged in numerous discussions and negotiations with PacifiCorp, the Division and the Committee. US Mag has determined that a non-firm QF arrangement is in its best interest. This supplemental testimony will explain why US Mag is now requesting a non-firm power sales contract rather that a firm agreement.

Submitted for approval with this supplemental testimony is a non-firm QF contract that has been negotiated between PacifiCorp and US Mag. As explained by Mr. Griswold in his Rebuttal Testimony in this docket dated September 17, 2004, several weeks ago PacifiCorp and US Mag reached tentative agreement on terms and conditions for the attached contract that are fully consistent with the QF Stipulation. Dr. Powell's Direct Testimony in this docket dated September 10, 2004, also recognizes that the terms of the agreement between US Mag and PacifiCorp are generally consistent with the QF Stipulation. However, while the Division and Committee have not filed testimony in this docket explaining any concerns, my understanding is that some parties might have some concerns regarding the proposed 20-year term of the agreement and/or the transmission loss adjustment. This supplemental testimony will also explain why both of these contractual terms are appropriate and fully consistent with the QF Stipulation.

Q. Why did US Magnesium decide to request a non-firm agreement?

A. There are four primary reasons why US Magnesium decided to pursue a non-firm agreement rather than a firm agreement: (1) To provide backup power supplies to US Magnesium during interruptions to US Magnesium's electric service; (2) The economics of US Mag's operations are such that QF generation may not be economical at certain times; (3) To avoid burdensome credit requirements requested by PacifiCorp for a firm contract; and (4) US Magnesium is currently exploring alternative electric generation scenarios that may require contractual changes in the future.

Q. With respect to the first reason, why does US Magnesium need a backup power supply?

A. US Magnesium's power supply arrangement is based upon interruptible deliveries. In the event of physical interruptions, US Magnesium must have the capability to meet its critical power needs in some manner. This onsite generating capability has as times been cited as a reason why US Magnesium can tolerate interruptible service. Given the significant potential physical interruptions contemplated under power supply arrangements in 2005 and beyond, our need for QF flexibility is much greater.

Q. Your second reason for a non-firm arrangement references economics of QF generation. Can you explain why the cost of QF generation is a factor in seeking a non-firm contract?

A. Yes. The heat requirements of the magnesium facilities can be produced either through the QF generation facilities or by other systems that utilize natural gas. It makes sense for US Mag to operate the QF facilities only when the net cost of running the generation system is less than the net cost of running the alternative systems. When the cost of the extra gas and O&M to produce power are greater than the value received from running the generation and selling the output, it makes no sense to run the QF generation except during interruption conditions. The economics of QF generation is very close to break-even when compared to alternative sources of heat at this time. A firm QF contract might require us to operate the QF facilities even when it is not economical.

Q. How about the third factor, the credit requirements for a firm service agreement?

A. We are familiar with the substantial credit requirements imposed on Desert Power for a firm agreement. Those requirements would be very difficult for US Mag to meet.

Q. Please comment on the fourth factor, the alternative generation systems that US Magnesium is exploring.

A. US Magnesium is looking into increasing the size of its generation, if economics permit. US Magnesium is also looking at various operating changes that would allow the plant to use clean coal technologies. Any change of this type would likely involve large capital outlays and would likely necessitate different contractual conditions in order for the project to obtain financing. The flexibility to negotiate an alternative arrangement is greater under a non-firm arrangement.

Q. Please generally describe the terms of the contract that US Magnesium has negotiated with PacifiCorp and submitted for approval.

A. The contract has a 20-year term, as expressly authorized by the Commission-approved QF Stipulation. The non-firm pricing, also based on the approved QF Stipulation, uses published Palo Verde index prices discounted by 7% to reflect the value of operating reserves. Under the approved QF Stipulation, this is the price that a firm contract customer receives when it runs in non-dispatch hours.

Q. Why is a 20-year term appropriate?

A. The 20-year term was expressly negotiated by US Mag and others in the QF Stipulation and was approved by the Commission. Denying US Mag the benefit of the Stipulation that it helped negotiate would be unfair and inappropriate. Others have received such a term and there is simply no legitimate reason to deny it to US Mag. Moreover, a non-firm agreement with an energy price tied to a widely-used index should not present any significant concerns.

Q. What about the line loss factor included in the contract?

A. This factor is also based on the QF Stipulation and on the approved Desert Power contract. The QF stipulation specified in section 5 that “appropriate adjustments” would be made to the prices based on operating characteristics of each specific plant. One such operating characteristic that is clearly relevant and appropriate is the degree to which a specific QF facility avoids line losses that would occur if the utility generated or purchased an equivalent amount of energy. Applicable federal regulations, 18 CFR Ch. 1 292.304, Rates for Purchases, clearly identify avoided line losses as one of the factors that should be taken into account in setting avoided cost rates. See Exhibit USM 1S.1. This obviously-relevant factor was recognized as such in the Desert Power QF contract, which included a compromise line loss adjustment percentage of 4.92%. Since US Magnesium is at the very same location, it makes sense to use this same percentage, and that is the percentage that was negotiated with PacifiCorp for use in the contract that is submitted for approval.

I can demonstrate from an engineering perspective that avoided line losses for this site should be much higher. In fact, a 1995 line loss study prepared by PacifiCorp, attached hereto as Exhibit USM 1S.2, shows that line losses to the Rowley substation located at the US Mag site were 7.2%, assuming a load of 80 MW. We remain willing to accept the Desert Power compromise value of 4.92%. However, if other parties who accepted the benefit of that compromise in the Desert Power case refuse to continue to accept it here, we submit that the appropriate line loss adjustment should be at least 7.2%

Q. Does this complete your testimony?

A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email or US Mail, postage prepaid, this 15th day of November, 2004, on the following:

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