BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UM 1182

PHASE 2

In the Matter of **NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION** **Petition for an Investigation Regarding Competitive Bidding**	))))))))	PREHEARING LEGAL BRIEF OF THE NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION

INTRODUCTION

Pursuant to the procedural schedule in this docket, the Northwest and Intermountain Power Producers Coalition ("NIPPC") respectfully submits its pre-hearing legal brief with the Public Utility Commission of Oregon ("OPUC" or "Commission"). NIPPC appreciates the Commission's continued efforts to make requests for proposals ("RFP") as fair and transparent as possible through this docket's investigation of RFP Guideline 10(d), which requires the independent evaluator ("IE") to compare the unique risks and advantages of utility benchmark proposals. Currently, independent power producers ("IPP") must bid fixed price power purchase agreement ("PPA") structures against "cost-plus" bids for utility-owned generation ("UOG"). The Oregon IEs have identified this problem in past RFPs. But the Commission has found that IEs have failed to provide an adequate accounting of the risks to ratepayers.

NIPPC respectfully recommends that the Commission should require the transparent use of bid adders to ensure that UOG bids properly account for cost and performance contingencies that IPP bidders must incorporate into their bids. Specifically, the Commission should amend

the Guidelines to require the IE to apply bid adders to UOG projects to account for the risk associated with (1) cost overruns through the first 5 years of operation, (2) heat rate degradation for a gas plant, and (3) lower than expected capacity factors for a wind plant. Additionally, with regard to the issue of "counter party risk," NIPPC recommends that the Commission should eliminate scoring penalties for irrelevant credit determinations for PPA bids. To fully level the playing field with regard to credit, NIPPC further suggests that the Commission may consider further reforms to overcome utility self build bias.

REGUALTORY BACKGROUND

A. THE COMMISSION'S AUTHORITY TO REGULATE PUBLIC UTILITIES

With few exceptions, Oregon's investor-owned electric utilities possess a monopoly in the supply of retail electricity within allocated service territories and are allowed to earn a reasonable rate of return on their investments in providing that service.[1] *See* ORS 756.040(1), 758.450. Oregon law thus requires the Commission to "protect . . . customers, and the public generally, from unjust or unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates." ORS 756.040(1). The Oregon legislature granted the Commission "the broadest authority – commensurate with that of the legislature itself – for the exercise of [its] regulatory function." *Pacific Northwest Bell v. Katz*, 116 Or. App. 302, 309 n.5 (1992) (internal quotation omitted). The Commission therefore possesses broad authority to ensure that the utilities procure the most cost-effective mix of utility-owned and non-utility-owned generation resources in order to provide fair retail rates.

B. THE COMMISSION'S COMPETITIVE BIDDING POLICIES

The Commission has long recognized the potential benefits of a fair competitive bidding

[1] Oregon law provides a few limited exceptions to the utilities' exclusive right to serve retail users located within the utilities' respective service territories. *See* ORS 758.450(4); 757.600 - 757.689.

process in the procurement of generation sources. *See Re Competitive Bidding by Investor-Owned Electric Utility Companies*, OPUC Docket No. UM 316, Order No. 91-1383, 127 PUR 4th 306 (1991). In the 1991 Order, the Commission determined, with a set of broad goals and guidelines, that competitive bidding should complement the Integrated Resource Planning Process and assist utilities in obtaining the optimal mix of power resources. The Commission noted its staff's opinion that "a utility affiliate's participation in the utility's own RFP *could damage the perceived credibility and fairness of the bidding process* (e.g. self-dealing) and contravene basic utility rate-making policy." 127 PUR 4th at 316 (emphasis added). The Commission agreed that "a utility or its affiliate should not submit bids in response to the utility's own bid solicitation." *Id.* The initial competitive bidding goals from Order No. 91-1383 were not mandatory, however, and contained flexible guidelines.

The Commission updated the 1991 Guidelines in a 2006 order. *Re Investigation Regarding Competitive Bidding*, OPUC Docket No. UM 1182, Order No. 06-446 (2006). There were several notable changes from the 1991 Guidelines. First, the Commission decided in Guideline 1 that utilities must conduct an RFP for all major resource acquisitions, subject to certain exceptions in Guideline 2. *Id.* at 3-4. Second, the Commission determined in Guideline 4 that the utility may submit a self-build option in an RFP offered on a cost-of-service basis, or similarly could accept ownership transfers within an RFP solicitation. *Id.* at 5. This was a major departure from the concern in the 1991 order that a utility or its affiliate's bid in the utility's own RFP could damage the perceived credibility and fairness of the bidding process by raising questions of self-dealing. To mitigate this concern, among other purposes, the Commission required in Guideline 5 that the utility use an independent evaluator to ensure the process and bid scoring are fair. *Id.* at 6-7.

The IE analyzes the RFP design, oversees the utility's scoring of the bids, and provides a final report on the shortlist selection to aid the Commission. *Id.* at 6-9, 12-14. Most relevant to this proceeding, Guideline 10(d) states as follows:

> If the RFP allows affiliate bidding or includes ownership options, the IE will independently score the utility's Benchmark Resource (if any) and all or a sample of the bids to determine whether the selections for the initial and final short-lists are reasonable. In addition, *the IE will evaluate the unique risks and advantages associated with the Benchmark Resource (if used), including the regulatory treatment of costs or benefits related to actual construction cost and plant operation differing from what was projected for the RFP*.

Id. at 12 (emphasis added). The Commission explained the reasoning behind Guideline 10(d) as follows:

> Fourth, pursuant to PGE's proposal, we modify language, set forth in subsection (d), to make the discussion on risk more neutral. *<u>We</u> <u>reject</u>, however, <u>PacifiCorp's</u> <u>recommendations</u> that the Benchmark Resource option should not be treated and evaluated like a bid and <u>that</u> <u>non-price</u> <u>factors,</u> <u>such</u> <u>as</u> <u>possible</u> <u>cost</u> <u>overruns,</u> <u>should</u> <u>not</u> <u>be</u> <u>considered</u>.* We recognize that Benchmark Resources are different from other bids in that price and performance is not fixed. Such differences, however, emphasize the need to consider *the additional risk* customers bear in deciding the best option from the RFP. *This risk to customers is present even if the actual costs of the Benchmark Resource are equally likely to be lower or higher than projected in the RFP.*

Id. at 13 (emphasis added).

C. THE RE-OPENING OF THE COMPETITIVE BIDDING GUIDELINES

The 2006 Guidelines were only one part of the Commission's ongoing efforts to provide ratepayers the benefits of an optimal mix of power resources. The Commission also opened docket UM 1276 in August 2006 "to address the *bias inherent* in the utility resource procurement process *that favors utility ownership of generation assets over PPAs* with third parties." *See Re An Investigation Regarding Performance-Based Ratemaking Mechanisms to Address Potential Build-vs.-Buy Bias*, OPUC Docket UM 1276, Order No. 11-001, at 1 (2011) (emphasis added).

The Commission also addressed a long-standing docket it had opened to examine whether new generating resources should be included in revenue requirement at market price, or whether new resources should be included at the utility's cost. *See Re Investigation Into Regulatory Policies Affecting New Resource Development*, OPUC Docket No. UM 1066, Order No. 11-007 (2011). The Commission ultimately declined to adopt any incentive mechanisms aimed at overcoming utility ownership bias in docket UM 1276. Order No. 11-001 at 5-6. The Commission also repealed the rule requiring utilities to recover costs at market prices in docket UM 1066, instead expressing its preference to return to a cost basis for utility-owned resources. Order No. 11-007 at 1-2.

However, in doing so, the Commission stated that it accepts "the premise that a bias exists in the utility resource procurement process that favors utility-owned resources over PPAs." Order No. 11-001 at 5. The Commission found, "This bias is really a logical inference drawn from an understanding of ratemaking practices and the effectiveness of incentives." *Id.* In short, "under cost of service regulation, a utility's 'profit' is the opportunity to earn a return on the rate base and by purchasing a PPA in lieu of building a power plant, it is foregoing the potential to earn some amount of profit." *Id.* (quoting Commission Staff's Comments). The Commission stated, "Although these guidelines have greatly increased confidence that the utility RFP process is being conducted fairly and properly, we believe further *improvements are needed to fully address utility self-build bias*." *Id.* at 6 (emphasis added).

Directly relevant to this brief, the Commission asked the parties to provide recommendations to improve Guideline 10(d). The Commission stated:

> Guideline 10(d) requires the IE to evaluate the unique risks and advantages of utility benchmark resources, including consideration of the regulatory treatment if construction costs and plant performance should differ

> from expected levels. In practice, *the IE's evaluation* of the comparative risks and advantages of utility benchmark resources *has not met our expectations*. When the benchmark has been a natural gas resource, the evaluation has primarily focused on the terms of the engineering, procurement, and construction (EPC) contract. When the benchmark has been a wind resource, the evaluation has tended to focus on the value of the site location after the plant's useful life. *We want a more comprehensive accounting and comparison of all of the relevant risks, including consideration of construction risks, operation and performance risks, and environmental regulatory risks.* We also want more in-depth analysis of all of these risks. We invite comment on the *analytic framework and methodologies that should be used to evaluate and compare resource ownership to purchasing power from an independent power producer.*
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> *Id.* at 6 (emphasis added).

PROCEDURAL BACKGROUND

The parties first held a series of workshops on the Commission's directive, identifying a list of twelve comparative risks or advantages (items) to consider in improving Guideline 10(d). The parties then filed comments recommending a reduced list of elements warranting further investigation. By procedural ruling dated May 30, 2012, Administrative Law Judge ("ALJ") Kirkpatrick determined further consideration of three issues was warranted, which included: (1) Cost Over-runs and Under-runs, (2) Heat Rate Degradation, and (3) Counter Party Risk. After certification of the ALJ Ruling, the Commission determined by order dated August 23, 2012, that investigation of a fourth factor was also warranted – (4) Wind Capacity Factor.

On November 16, 2012, NIPPC, Portland General Electric Company ("PGE"), PacifiCorp, Idaho Power Company ("Idaho Power"), and Commission Staff each filed opening testimony. On January 14, 2012, those same parties and the Citizens Utility Board of Oregon ("CUB") filed reply testimony. The procedural schedule calls for pre-hearing briefs, an evidentiary hearing, and then post-hearing briefs. A date is preserved for oral argument if the Commission wishes to hold oral argument.

ARGUMENT

A. THE COMMISSION SHOULD ADOPT BID ADDERS TO ADDRESS THE RISK INHERENT WITH ANY "COST-PLUS" UTILITY OWNERSHIP PROPOSAL.

Oregon IEs have had difficulty implementing Guideline 10(d). PacifiCorp's past IE, Boston Pacific, has stated that the problem with a benchmark bid "is that it is offered on a *cost-plus* basis while third-party bidders are required to guarantee their price and performance parameters." *Re PacifiCorp: Request for Approval of Final Draft 2011 All Source Request for Proposals*, OPUC Docket No. UM 1540, Order No. 12-111, Appendix A at 15 (2011) (emphasis added). Rather than accounting for the identified risk by modifying its evaluation of UOG bids, Boston Pacific has "routinely requested that the Company to be held to its cost and performance projections in future rate cases should it be declared a winner." *Id.* Boston Pacific has noted that even when PacifiCorp provided no benchmark, "the 'soft costs' or 'owners costs,' which are added to the [engineering, procurement and construction ('EPC')] costs to get the full cost of the project, are still not definite. . . . [and] we would continue to ask that the Commission hold the Company to their cost estimates in future ratemaking cases." *Id.*; *see also* Confidential NIPPC/311, Monsen/9. Similarly, PGE's IE has highlighted the risk differential between a PPA and a UOG structure with regard to wind capacity factor errors, and even proposed that "a risk adjustment should be assessed to the ownership option." NIPPC/300, Monsen/46. But the IE provided no actual means for accounting for this risk differential.

Identifying risk differentials without actually implementing any adjustment to bid evaluation and leaving the problem unaddressed until a future ratemaking proceeding is not adequate – as the Commission itself suggested when it commenced this investigation. *See* Order

No. 11-001 at 6. A quantitative method of accounting for risk during the bid evaluation process is warranted.

NIPPC recommends that bid adders should be incorporated into the Guideline 10(d) analysis, and that the Commission should require the IE, as part of the analysis to create an RFP's shortlist, to apply each adder to the price evaluation of any bid that would result in utility ownership after commissioning the plant. NIPPC/100, Monsen/3. NIPPC's proposal reasonably recognizes that, under unique circumstances, a particular bid adder may not be applicable to a particular utility ownership bid. For example, if the utility were to properly reflect future increases in heat rate in its UOG proposal, then a heat rate adder may not be needed. *See id.* NIPPC proposes that the utility will bear the burden of demonstrating to the Commission (after opportunity for comment by the IE, Commission Staff, and non-bidding stakeholders) that the utility ownership proposal properly takes into account the potential cost increase addressed by the particular bid adder. *Id.* The evidence supporting NIPPC's proposed bid adders is too extensive to fully repeat in this brief, but the following sections will briefly highlight the evidence supporting bid adders.

1. The Evidence Supports Development of a Bid Adder for the Risk of Cost Overruns.

It is standard industry practice to include a construction cost contingency in any cost projection for a major generation resource. This is so even with a project that has an EPC contract. As NIPPC's witness testified at length, "even a well-drafted EPC contract will not protect the utility or its ratepayers against all contingencies and risks." NIPPC/500, Kasper/2. PacifiCorp itself stated that accounting for contingencies is "consistent with industry practices," and thus PacifiCorp has used cost contingencies even for UOG bids supported by an EPC

contract. *See* PacifiCorp/100, Kusters/19-20; NIPPC/500, Kasper/10; NIPPC/502, Kasper/1-3. However, only PacifiCorp has claimed to use such an adder in bid evaluation, and no utility in this proceeding has committed to do so in the future. Furthermore, PacifiCorp's past use of a cost adder appears to overlook cost over-runs and deferred capital additions that spill into the first five years of operation and is not large enough to account even for the full risk of cost over-runs during the initial construction period. *See* NIPPC/300, Monsen/21. The Commission should *require* use of a contingency adder by the IE in its evaluation of UOG projects to account for the full magnitude of the risk of cost overruns in UOG projects.

NIPPC recommends that the IE should apply a bid adder of 7.0% to the estimate of initial construction costs for UOG projects to account for the significant risk posed by a cost overrun. *See* NIPPC/100, Monsen/11-13. NIPPC's witness developed this bid adder by calculating the capacity-weighted average percentage change in the installed cost relative to the cost that was initially proposed or approved for the eleven gas-fired, UOG plants that have entered service in California in the past ten years. *See id*. This bid adder accounted for the potential for cost under-runs as well as cost over-runs on the initial installation cost for a plant. NIPPC's witness fully incorporated the possibility for cost under-runs in calculating this adder by including UOG plants in the sample that experienced cost under-runs as well as cost over-runs. NIPPC/100, Monsen/12. A bid adder is additionally appropriate because cost over-runs have the potential to be much greater in magnitude than cost under-runs. NIPPC/100, Monsen/17-18. Furthermore, an adder is appropriate because, as the Commission has itself stated, "This risk to customers is present even if the actual costs of the Benchmark Resource are equally likely to be lower or higher than projected in the RFP." Order No. 06-446 at 13.

In addition, NIPPC recommends that bid evaluation for UOG projects should include an incremental bid adder equal to at least 5.7% of the initial construction costs (in addition to the 7.0% adder) per year for the first five years of plant operations. This would properly account for the risk of latent defects that can occur outside the protections of any EPC contract, as well as the risk of deferred capital expenditures that were delayed to evade the scrutiny of the Commission's examination of the plant's initial installed cost at the time it first enters rate base. NIPPC/100, Monsen/19-20. NIPPC's witness calculated this adder based upon Cost of Plant data in FERC Form 1s for the same set of California plants built in the last ten years. NIPPC/100, Monsen/20-23. It should be noted that California plants are not the only plants that have incurred cost over-runs after they come online. NIPPC was also able to calculate an alternative annual adder of 4.3%, using the same methodology using FERC Form 1 data for seven gas-fired plants and twelve wind plants owned by the Oregon utilities. NIPPC/100, Monsen/23-24.

NIPPC's proposed adder for deferred capital additions and latent defects is conservative. *See* NIPPC/300, Monsen/23-24. For example, Idaho Power has argued that ratepayers were insulated by insurance for one of the latent defects identified by NIPPC -- a $14 million overrun at the Bennett Mountain Plant. Idaho Power/200, Stokes/13. But NIPPC's adder did not include the cost of this latent defect because this cost was not included in Idaho Power's FERC Form 1 data. *See* NIPPC/300, Monsen/23-24.[2] NIPPC's testimony also identified specific projects at Bennett Mountain and several other Oregon UOG plants where the utilities confirmed that significant capital costs were passed onto Oregon ratepayers shortly after the UOG plant initially entered rate base. NIPPC/300, Monsen/22-23. Additionally, NIPPC's testimony addressed a concern raised by Commission Staff by providing analysis supporting alternative adders calculated specific to

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[2] NIPPC also disputes Idaho Power's assertion that insurance insulated rate payers for the entire cost of this particular latent defect. NIPPC intends to supplement the record with additional discovery on this matter at the hearing, or by stipulation.

combined cycle or simple cycle combustion plants for initial installed costs and for deferred additions in the first five years. NIPPC/300, Monsen/26.

The Commission should not accept PGE's assertion that no contingency adder is needed for UOG projects with an "overall plant construction cost guarantee" from an EPC contract. PGE/100, Outama-Bettis-Mody-Hager/22. Even with an EPC contract, the risk remains for change orders, cost overruns exceeding the EPC contract's damages cap, latent defects appearing after expiration of the EPC contract, and the utility's *ownership* of the project and any problems arising beyond the scope of the EPC contractor's liability. NIPPC/500, Kasper/10-14, 17-19. Furthermore, PGE's proposal would result in continuation of the current IE bid evaluation practice that the Commission seeks to improve in this docket. *See* Order No. 11-001 at 6 (expressing dissatisfaction that, when the resource is a gas plant, "the evaluation has primarily focused on the terms of the engineering, procurement, and construction (EPC) contract.").

Finally, the utilities have criticized NIPPC's use of initial installed costs data from California utilities, but the utilities' incomplete discovery responses left NIPPC with no other viable alternative. *See* NIPPC/100, Monsen/ 14-16. NIPPC recognizes that the Commission prefers resolution of discovery issues through a motion to compel discovery. However, in this case, such a motion would have faced difficulty of overcoming objections of undue burden until after the utilities claimed in testimony that Oregon plants have not experienced cost overruns. Additionally, even after putting the topic directly in issue, the utilities have been unable to support their claims with directly relevant material because, in at least some cases, they do not possess such information. For example, PGE's four witnesses testified that the UOG Biglow wind plant experienced no cost overruns. PGE/100, Outama-Bettis-Mody-Hager/24. But PGE was unable to even provide useful RFP cost projections for comparison to the initial installed

costs for that plant because PGE had changed the project's configuration *after* the RFP concluded. NIPPC/300, Monsen/10. Similarly, Idaho Power asserted in discovery that it no longer possesses scoring materials from the 2005 RFP won by Idaho Power's Bennett Mountain UOG gas plant. *See* NIPPC/300, Monsen/9. Worse yet, Idaho Power and PacifiCorp both waited until *reply* testimony to even make specific claims that they have experienced no cost overruns. *See* Confidential PacifiCorp/204; Idaho Power/201.

A comprehensive set of Oregon specific data on the utilities' alleged installed costs is either non-existent or has been put in issue too late to be subjected to full scrutiny. The Commission should therefore reject the attempt by the utilities to "cherry pick" selective data on *initial* installed costs for their own plants in support of their claim that they have experienced no cost overruns. The utilities have failed to rebut the evidence that they have each "gold plated" their UOG projects after the scrutiny of their projects' initial installed costs ended or otherwise experienced the need for additional capital expenditures during the early years of their projects' operations. A cost overrun bid adder is warranted.

2. The Evidence Supports Adoption of a Bid Adder for the Risk of Heat Rate Degradation.

NIPPC's testimony supports requiring use of a bid adder to account for heat rate degradation. If a plant uses more fuel than expected to generate a set amount of power (i.e., has a higher-than-expected heat rate), the plant's fuel costs increase. NIPPC/100, Monsen/24. Thus, this adder should apply to proposed projects that burn natural gas whenever ratepayers would be responsible for fuel cost increases associated with a higher-than-anticipated heat rate. NIPPC/100, Monsen/25. Utility witnesses have acknowledged that a guaranteed heat rate is a common element of a tolling service agreement ("TSA"), which ensures that degradation in heat

rate beyond the guaranteed level will not impact the price paid by the utility and ratepayers to the IPP for plant operation. PAC/100, Kusters/14-15; *see also* Idaho Power/100, Stokes/13.[3] PacifiCorp's witness even testified that an IPP offering a guaranteed heat rate in a TSA would embed a risk premium into the price of the TSA in the form of a heat rate margin. PAC/100, Kusters/15-16. NIPPC agrees. Indeed, that is the reason a bid adder is needed. It would require a corresponding risk premium being embedded into the UOG bid price. *See* NIPPC/300, Monsen/32-33.

NIPPC proposes a bid adder to heat rate estimates for gas-fired UOG plants such that the average expected plant heat rate over the course of the analysis period is at least 8.0% above the starting heat rate. NIPPC/100, Monsen/27. For this adder, NIPPC's testimony utilized a nationwide database of annual cost and operating characteristics of 245 UOG plants for the years 1981 through 1999, and averaged together observed heat rate changes, weighted by capacity factor. NIPPC/100, Monsen/25-26. NIPPC's testimony further demonstrates an adder is warranted through evidence of higher than expected heat rates at Oregon utility plants. NIPPC/300, Monsen/8-9, 27-28. It is important to note that Oregon ratepayers have borne the costs of heat rate degradation. The utilities could not identify any cost disallowances resulting from prudence reviews related to heat rate degradation. *Id.* An adder is therefore needed.

NIPPC's proposal has addressed several concerns raised by current and past Commission Staff. *See* NIPPC/300, Monsen/33-36. NIPPC's testimony presented a capacity-weighted average heat rate degradation of 10.4% for the Oregon plants, which could be used if the Commission agrees with concerns raised regarding the vintage of the plants in the larger,

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[3] *But see* PGE/100, Outama-Bettis-Mody-Hager/17 (claiming that bidders are not proposing a guaranteed heat rate in the current market). Despite making this claim, PGE provided no confidential or redacted bid scoring or submittal materials from RFPs that would support this claim. In any event, NIPPC's proposal would require such IPP bids proposing a TSA without a heat rate guarantee to be subjected to the same heat rate adder.

nationwide database. *See* NIPPC/100, Monsen/27-28; NIPPC/300, Monsen/34-35. NIPPC's testimony also provided analysis that weighted the heat rate degradation by energy production to derive an alternative to the capacity factor-weighted adder, which would result in a bid adder of 5.5% based on the nationwide dataset or a bid adder of 8.9% based on the Oregon UOG plants. NIPPC/300, Monsen/35-36.

The utilities have speculated as to various reasons for heat rate degradation at their plants, and instead of NIPPC's adder they propose using the very low projections for heat rate degradation provided by the Original Equipment Manufacturers ("OEM") for purposes of selling the equipment. *See, e.g.,* PAC/100, Kusters/11-12, 17. These arguments are not persuasive. As PGE's reply witness, Dr. Jonathan Jacobs, admits, "The manufacturers' estimates of heat rates could be incorrect or based on unrealistic operating conditions." PGE/300, Jacobs/8. No utility provided a quantitative recommendation for heat rate degradation other than these OEM projections. *See* NIPPC/300, Monsen/29-32. Although Dr. Jacobs attempted to quantify his own heat rate degradation estimate, even he ultimately concluded his results were "counter-intuitive," and merely recommended further analysis of data that he believes may be unavailable. PGE/300, Jacobs/28, 30. The utilities have overcomplicated the issue, and have failed to disprove the overwhelming evidence that heat rate degradation occurs.

Finally, PGE appears to claim it can obtain a guaranteed heat rate through a long-term service agreement ("LTSA") with the OEM. PGE/100, Outama-Bettis-Mody-Hager/17-19. It may be true that a utility could obtain the equivalent of a heat rate guarantee through an LTSA for a UOG plant. However, as NIPPC's witness testified, in exchange for such a guarantee, the OEM will require that it have the discretion to require capital upgrades and expenditures paid for by the utility in order to keep the plant running within the OEM's specifications. NIPPC/500,

Kasper/13-14. Such an LTSA agreement therefore imposes the potential for ongoing upgrades and more frequent scheduled outages that must be built into the cost assumptions for the plant – thereby shifting the ratepayer risk from heat rate degradation to other cost categories. *Id.* Thus, if the Commission accepts PGE's argument, it should require the IE not to accept "risk free guarantees" in LTSAs, and require the IE to provide a detailed accounting of the excess capital expenditures and down time for maintenance that the OEM will require in the LTSA. As PacifiCorp has acknowledged, a prudent IPP would need to incorporate such incremental costs associated with an LTSA into its bid price. *See* PAC/100, Kusters/15-16. It is only fair that the UOG bids be required to as well.

3. The Evidence Supports a Bid Adder for the Risk of Over-Estimates of Wind Capacity Factors.

The Oregon IEs have specifically noted the risk differential for wind capacity factor error at a UOG plant compared to a PPA structure. The IPP is only paid a fixed price per MWh and renewable energy credit produced, while the UOG project passes on all prudent capital costs of the project to ratepayers regardless of actual production. NIPPC/300, Monsen/37. In Accion's words, "the ownership option . . . comes with significant capacity factor risk for the ratepayer which would be borne by the counterparty in a PPA structure." NIPPC/300, Monsen/43; *see also* Confidential NIPPC/300, Monsen/45-46 (discussing Boston Pacific's conclusions). Accion Group has noted in one IE report that two capacity factor estimates for a UOG bid that were completed within three months of each other varied by more than 5%, and this affected the projected levelized cost of the project by about $20 per MWh. NIPPC/300, Monsen/44. As noted above, Accion has recommended a "risk adjustment" for UOG bids, but thus far no IE has developed any such quantitative adjustment.

A bid adder is needed for this risk differential, which has undeniably increased actual costs to Oregon ratepayers compared to the assumptions for the UOG plants at the time of resource selection. NIPPC presented compelling evidence of systemic capacity factor over-estimates at PacifiCorp's 12 wind plants that began operating prior to 2010.[4] NIPPC/100, Monsen/30. NIPPC recommends a bid price adder for UOG wind plants of 11.7% based upon this publicly available data and a slightly revised percentage based upon additional confidential information. NIPPC/100, Monsen/31.

Attempts to explain away the relevance of this data are unavailing. NIPPC's testimony thoroughly refuted the assertion that PacifiCorp's systemic over-estimates can be attributed to past, industry-wide forecasting errors by demonstrating the difference in forecast error between the UOG plants and contemporaneous IPP plants selling to Oregon utilities under PPAs. *See* Confidential NIPPC/300, Monsen/36-40. Additionally, the UOG plants coming online after the alleged industry-wide improvements in forecasting technology also operate at lower-than-expected levels. *See* NIPPC/300, Monsen/41-42. The evidence supports a conclusion that the demonstrated error at UOG plants is largely attributable to the incentive to over-forecast wind projection at a UOG plant.

PacifiCorp and PGE appear to even acknowledge the problem by recommending use of a "Capacity Factor Expert" to analyze all short list bids in future RFPs. While NIPPC agrees this is a good suggestion that should be *required* in all renewable RFPs, it does not remove the need for bid adders, or a "risk adjustment" in Accion's words. *See* NIPPC/300, Monsen/48. First, this expert would not be able to evaluate the capacity factors of *all* bids in the RFP, and UOG bids

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[4] PacifiCorp data is the most relevant in this category. As noted above, PGE stated in discovery that the RFP bid for its Biglow plant was not comparable to the project as built because PGE changed the project configuration *after* conclusion of the RFP. *See* NIPPC/307, Monsen/1-2. Idaho Power owns no wind projects.

could make it to the short list improperly. *Id.* Additionally, while the expert may provide a best estimate of capacity factor given available information, the expert would not be able to address the differential in *risk* of a forecasting error between a UOG and IPP project. Only bid adders can fully address this risk.

4. The Record Provides Abundant Support for a Determination by the Commission to Require Bid Adders.

The Commission should reject any argument the utilities may make that the record lacks sufficient evidence to support a Commission determination that bid adders are warranted for "cost-plus" utility resources. The Commission's fact-finding authority is broad when its findings are supported by substantial evidence. *See Indust. Customers of Northwest Utilities v. Pub. Utility Commn. of Or.*, 240 Or.App. 147, 164 (2010). The weight to be given to expert witnesses in an administrative proceeding is a question for the fact finder, and thus substantial evidence exists notwithstanding conflicting expert opinions. *See Friends of Parrett Mountain v. Northwest Natural Gas Co.*, 336 Or. 93, 106 (2003).

As discussed in detail above, NIPPC has presented extensive evidence that there is a significant risk of cost overruns, heat rate degradation, and wind capacity factor overestimation errors. A prudent IPP must incorporate the potential cost associated with those risks into its fixed price RFP bid for a PPA structure. Without mandatory bid adders, a "cost-plus" UOG bid could easily ignore the full magnitude of these risks during RFP evaluation and later pass actual cost increases onto ratepayers. Indeed, NIPPC's witness has demonstrated that the Oregon utilities have passed the costs of UOG cost overruns, heat rate degradation, and wind capacity factor overestimation errors onto Oregon ratepayers. *See, e.g.,* NIPPC/100, Monsen/31; NIPPC/300, Monsen/8-9, 22-23, 27-28. Substantial evidence therefore indisputably exists for the

Commission to correct the process by requiring bid adders for UOG bids, notwithstanding conflicting expert opinions presented by the utilities that these risks do not exist for Oregon utilities and their ratepayers.

B. THE COMMISSION SHOULD DIRECT THE UTILITIES TO STOP PENALIZING IPPS FOR IRRELEVANT CREDIT SCORES CURRENTLY USED AS A PROXY FOR COUNTER PARTY RISK AND CONSIDER FURTHER REFORMS TO LEVEL THE PLAYING FIELD WITH REGARD TO CREDIT.

The utilities proposed to include counter party risk in this docket, but they have failed to present any compelling evidence that counter party risk or credit risk are ever likely to impose actual costs on Oregon ratepayers. NIPPC's witness, Camden Collins, thoroughly refuted the utilities' claims on this issue. NIPPC's witness demonstrated that the risk of actual damages to ratepayers is mitigated by PPA terms and the excess supply that exists in the market in the event of an inability to perform. *See* NIPPC/400, Collins/1, 4-5, 8-9, 14-19. Despite the specter raised by the utilities, they have provided no legitimate examples of actual damages being passed onto ratepayers as a result of counter party risk.

NIPPC's testimony also demonstrated the utilities are not currently conducting fair RFPs, and are instead penalizing the inability of IPPs' special purpose entities ("SPEs") to cost-effectively provide excessive credit assurances *prior to execution of a financeable PPA*. *See* NIPPC/400, Collins/1-13; NIPPC/401. While NIPPC agrees credit is relevant in short-term market transactions, it is simply not a relevant factor for a fully committed, long-term PPA prior to the time that the PPA is executed by the SPE. *See* NIPPC/400, Collins/6:15-17. The utilities overlook that it is the regulatory compact and guaranteed revenue stream for the plant that provides credit to both the UOG and IPP projects. NIPPC/400, Collins/5-6. Under the utilities' unfair scoring penalty to PPA bids, only UOG projects can benefit from that credit in the RFP.

The utilities' past and proposed use of credit also lacks transparency. NIPPC/400, Collins/6-7. NIPPC recommends a simple improvement would be to prohibit reliance on credit scoring prior to PPA execution, and instead make credit requirements applicable after execution. NIPPC/400, Collins/19. Additionally, NIPPC's witness has offered policy recommendations for a credit adder of up to 9% for UOG bids to partially adjust for the credit benefit provided to the utilities by the ratepayers in the evaluation process. NIPPC/400, Collins/19-20.

Finally, the utilities also proposed that certain contract terms be made "non-negotiable" to account for the specter of counter party risk. First, this recommendation goes beyond the Commission's request for an accounting of risks under Guideline 10(d). Because the utilities raised the issue, however, NIPPC reiterates its position that retaining the IE through final negotiations is the best mechanism to ensure PPA terms are as fair as possible for all parties, as allowed by the Commission in an earlier phase of this docket. Non-negotiable terms could be beneficial *only if* they are reasonable terms that are actually likely to result in executed PPAs. However, NIPPC's concern with "non-negotiable" terms drafted by the utility is that such terms can easily evade any real scrutiny – as evidenced by PacifiCorp's attempt to slip its terms into this proceeding in reply testimony. *See* PacifiCorp/208. Development of reasonable terms would require a level of oversight of the RFP process that the Commission's current policies do not allow. *See* Order No. 06-446 at 2 (noting the Commission's current goal for the process to "Be flexible, allowing the contracting parties to negotiate mutually beneficial exchange agreements"). Unless the Commission intends to seriously scrutinize proposed non-negotiable terms, the likely result will be non-negotiable terms to which no IPP would agree.

CONCLUSION

NIPPC respectfully proposes that the Commission revise the Guideline 10(d) analysis by

requiring the bid adders and policy directives discussed herein.

RESPECTFULLY SUBMITTED this 1st day of February, 2013.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 1st day of February, 2013, a true and correct copy of the within and foregoing PREHEARING LEGAL BRIEF OF NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION IN DOCKET UM 1182:

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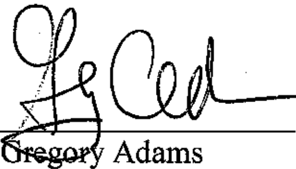
Signed 
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