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**	REDACTED POST-HEARING 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 post-hearing legal brief with the Public Utility Commission of Oregon ("OPUC" or "Commission"). The parties agreed to waive cross-examination and admit certain exhibits into the record in lieu of holding a hearing in this proceeding. NIPPC stands by all positions taken in its pre-hearing brief. This post-hearing brief will therefore address arguments made by the other parties in their pre-hearing briefs, as well as address the newly submitted exhibits.

As NIPPC noted in its pre-hearing brief, 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. The utilities would have the Commission overlook that independent power producers ("IPP") must bid fixed-price power purchase agreement ("PPA") structures against "cost-plus" bids for utility-owned

generation ("UOG"). IPPs cannot compete on equal footing in an Oregon RFP against these "cost-plus" bids without modifications to the analysis conducted under RFP Guideline 10(d). The most recent IE Report filed in docket UM 1535 only further demonstrates the need for additional guidance to Oregon IEs to enable meaningful analysis under RFP Guideline 10(d).

NIPPC again respectfully recommends that the Commission should require the transparent use of bid adders recommended by NIPPC in this docket to start movement toward ensuring that UOG bids properly account for cost and performance contingencies that IPP bidders must incorporate into their fixed-price 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) construction cost overruns through the first 5 years of operation, (2) heat rate degradation for a gas-fired power 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.

ARGUMENT

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

The Commission should reject the positions of the utilities because a more complete accounting by the Oregon IEs is necessary under RFP Guideline 10(d). The Commission's RFP bidding process will lose credibility among IPPs if the utilities continue to succeed in their efforts to own and place into rate base the major resources that emerge from Oregon RFPs. The RFP process will not continue to provide value to ratepayers if the risk differential between UOG

and IPP bids is not addressed in a transparent manner. NIPPC again asserts that the Commission should adopt mandatory bid adders for UOG projects to account for the risk to ratepayers associated with cost overruns, heat rate degradation, and wind capacity factor errors.

The Commission should reject the urging of other parties to this docket that data and methodological hurdles present an insurmountable obstacle to adopting bid adders to account for the risk inherent with UOG projects. *See, e.g., Staff's Prehearing Brief* at 3, lns. 15-20. These parties would impose insurmountable evidentiary burdens that would cripple the Commission's ability to exercise its broad regulatory authority to protect ratepayers. Substantial evidence indisputably exists for the Commission to begin to correct the RFP 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. *See Friends of Parrett Mountain v. Northwest Natural Gas Co*., 336 Or. 93, 106 (2003).

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

NIPPC maintains its recommendation 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 construction cost overrun prior to a plant coming online. *See* NIPPC/100, Monsen/11-13. In addition, NIPPC maintains its proposal for an incremental bid adder for each of the first 5 years of plant operations to capture the cost of deferred capital additions and latent defects. *See* NIPPC/100, Monsen/19-24. This adder is supported by FERC Form 1 data, and NIPPC stands by its recommendation of an adder equal to at least 5.7% of the initial construction costs per year based on data from the California plants, or alternatively an adder of 4.3% per year based upon data from several Oregon plants. *Id*. The Commission should *require* use of these contingency

adders by the IE in its evaluation of UOG projects to account for the full magnitude of the risk of cost overruns in UOG projects. The utilities' arguments against use of mandatory contingency adders for cost overruns are unavailing.

a. Idaho Power's and PacifiCorp's last-minute evidence on initial installed costs should be rejected.

The Commission should not rely on the last-minute submissions of initial installed costs at UOG plants owned by PacifiCorp and Idaho Power. Both utilities waited until reply testimony filed on January 14, 2013, to provide exhibits purporting to contain actual cost overrun or under-run data for their UOG plants. *See* Confidential PacifiCorp/204; Idaho Power/201. NIPPC asked for the underlying data for all of PacifiCorp's plants repeatedly in discovery prior to and after the filing of direct testimony. *See* NIPPC/113, Monsen/1-3 (first requesting this relevant material in NIPPC Data Request 2.1 on January 20, 2012). But PacifiCorp has now confirmed that the documents supporting PacifiCorp's last-minute exhibit "were not all provided with the Company's responses to NIPPC Data Requests 2.1, 3.3, or 3.6." NIPPC/600, Stipulated Exhibit/1. This material is therefore unreliable because it was provided too late to be fully scrutinized.

Even with the limited and preliminary review allowed by the late filing, it is obvious that these exhibits are unavailing to the utilities' position. For example, Idaho Power's exhibit purports to contain actual figures for the Danskin Mountain, Bennett Mountain and Langley Gulch plants. *See* Idaho Power/201. From these figures, Idaho Power asserts, "for Idaho Power's recently acquired UOG projects, the actual costs paid by customers have been well below the Company's bid price that was successful in the RFP process." *Idaho Power's Prehearing Brief* at 5. Idaho Power's discovery responses, however, demonstrate that the actual

amounts contained in the Certificates for Public Convenience and Necessity ("CPCN") were lower than the amounts Idaho Power provided in its exhibit as the costs used in RFP evaluation. *Compare* Idaho Power/201 (relying solely on the "Idaho CPCN Filed Commitment Estimate 'Bid'") *with* NIPPC/604, Stipulated Exhibit/1 (discovery response containing the "actual amounts in final CPCN orders"). Idaho Power apparently expects parties to believe that the commitment estimate was the estimate used for RFP bid evaluation purposes. However, when asked for RFP bid evaluation material, 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; NIPPC/306. It is difficult to accept Idaho Power's claims regarding assumptions in its RFPs when it has failed to provide all of the relevant evidence in discovery.

Idaho Power's reply exhibit also lacks credibility because it relies on "Actual Installed Costs" for its Langley Gulch plant that is still not yet complete. *See* Idaho Power/201. Idaho Power admitted in the limited window possible for discovery that the work order for Langley Gulch is not even yet closed, and will not be closed until July 2013. NIPPC/603, Stipulated Exhibit /1. This is yet another example of a utility attempting to take a premature snap shot of "final" costs for a project that it is inherently "cost plus."

Furthermore, both PacifiCorp and Idaho Power failed to provide data that would address NIPPC's proposal for an incremental bid adder for the first five years of plant operations. PacifiCorp even states "the timing of when costs associated with a project are included in customer rates is a function of the applicable ratemaking criteria rather than the in service date of the project." *PacifiCorp's Prehearing Brief* at 29. The Idaho Power and PacifiCorp reply exhibits containing costs at the time of the in service date therefore fail to 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. *See* NIPPC/100, Monsen/19-23.

b. The costly latent defect at Idaho Power's Bennett Mountain Plant fully supports NIPPC's position.

Idaho Power misleadingly claims the costly latent defect that occurred at its Bennett Mountain plant does not support inclusion of a bid adder for construction costs occurring after the plants are operational. *See Idaho Power's Prehearing Brief* at 12. Idaho Power is wrong.

First, and most importantly, the Bennett Mountain example demonstrates that NIPPC's proposed adder was conservative. NIPPC's adder using FERC Form 1 data did not include the full cost of this latent defect because the FERC Form 1 data netted out the retirement of parts taken out of service, which almost completely obscured the costs of the latent defect. *See* NIPPC/300, Monsen/23-24; *see also* NIPPC/608, Stipulated Exhibit/1. NIPPC provided evidence of this latent defect to demonstrate that costly latent defects at a UOG project are a real *risk* that can cause construction cost overruns after the initial installed date. *See* NIPPC/100, Monsen/19-20.

Second, Idaho Power is incorrect in its assertion that insurance protected ratepayers from all harm occasioned by this latent defect. According to Idaho Power, "the costs to repair the latent defect, which was caused by an IPP that constructed the plant, were never passed onto customers." *Idaho Power's Prehearing Brief* at 12 (citing Idaho Power/200, Stokes/13).[1] Idaho

[1] Furthermore, it is completely irrelevant to this docket that an "IPP" constructed the plant. The focus of this docket is on comparing the risks of utility *ownership* to a utility purchasing power under a power purchase agreement. Whether Idaho Power believes the entity that constructed this plant was an "IPP," and "EPC contractor" or some other type of construction company is not relevant.

Power's witness specifically testified that "the repair costs were covered by insurance and Idaho Power's customers were never at risk of having to bear these costs." Idaho Power/200, Stokes/13. This assertion is incorrect.

Despite Idaho Power's testimony, insurance did *not* fully protect ratepayers from this cost overrun. Idaho Power admitted in discovery that the cost to fully replace necessary parts and repair all necessary damage was $15,843,340, and Idaho Power did *not* receive an insurance check for that amount. NIPPC/605, Stipulated Exhibit/1. Instead, Idaho Power's insurance policy required a deductible payment of $2,500,000, and Idaho Power only received cash in the amount of $7,362,209. NIPPC/605, Stipulated Exhibit/1. Idaho Power appears to assert that it received a commercial credit and spare parts from the equipment supplier (not the insurance company) that made up the remainder of the $15,843,340 in damages. *See id.* But Idaho Power has provided no evidence that it actually needed the credit and spare parts. Furthermore, this large insurance claim resulted in a subsequent increase to Idaho Power's annual insurance rates. *Id.*

The record also supports a conclusion that, in the Bennett Mountain RFP, Idaho Power failed to properly account for costs of maintaining insurance for Bennett Mountain as well as reasonable contingencies that would be included for uncovered insurance amounts and increased future insurance costs. Idaho Power apparently did not deem the Bennett Mountain RFP material as worthy of a "litigation hold" and therefore stated it could not provide documents demonstrating that it properly allocated insurance costs to the UOG Bennett Mountain bid. *See* NIPPC/607, Stipulated Exhibit/1. This failure to retain relevant information from the Bennett Mountain RFP should be construed against Idaho Power. An adverse presumption should be applied against a party that discards evidence it knows or should know will be relevant or

discoverable in future litigation. *See Welsh v. United States*, 844 F.2d 1239, 1246-48 (6th Cir. 1988); *see also Glover v. BIC Corp.*, 6 F.3d 1318, 1329-30 (9th Cir.1993) (finding of bad faith is not required to apply this presumption). A regulated utility should know that *all* material used for purposes of evaluating the winning UOG bid in the utility's own RFP is potentially relevant in proceedings before the Commission. Indeed, no other utility to this docket appears to have destroyed RFP evaluation material.[2] Thus, the only proper inference is that Idaho Power failed to properly account in its RFP for the costs of maintaining an insurance policy for the UOG Bennett Mountain plant, the insurance deductible payment of $2.5 million, increased annual insurance costs resulting from the claim, or the amounts not covered by a cash payment from the insurance provider. This was a major cost overrun. And again, it was not even fully included in NIPPC's conservative adder calculated from FERC Form 1 data.

Moreover, Idaho Power's discovery responses even support a conclusion that costs associated with future construction defects at other UOG plants could be passed onto ratepayers. Idaho Power stated, "Construction defects are not a specific cause of loss within a commercial property insurance policy." NIPPC/606, Stipulated Exhibit 1. It appears Idaho Power only received the limited insurance payment for the latent defect at Bennett Mountain because a "resulting physical event" caused the damage. *See id.* This further supports the need for a bid adder to account for this risk of a future construction defect that has no insurance coverage whatsoever.

c. NIPPC's proposal for an adder for deferred capital additions using FERC Form 1 data has merit.

The utilities have completely failed to refute the fact that they have each experienced

[2] The other utilities have objected to providing much of RFP evaluation material on multiple other grounds throughout this proceeding, however.

significant capital expenditures shortly after the initial, in-service dates of their plants. The utilities claim that correcting NIPPC's FERC Form 1 analysis to properly account for depreciation results in a substantially smaller bid adder. *See Idaho Power's Prehearing Brief* at 12; PGE/300, Jacobs/38. By excluding depreciation from NIPPC's methodology using FERC Form 1 data, PGE's witness, Dr. Jacobs, calculated a capacity-weighted average value for the adder of 2.12% for the California plants. PGE/300, Jacobs/38. Thus, Dr. Jacob's own testimony demonstrates that a total cost increase of 10.6% above the initial capital cost occurred *in the first 5 years*. While Dr. Jacob's figure is less than what NIPPC's witness estimated, it is still significant – a 10.6% increase in capital costs in the first 5 years of operation at UOG plants. Without conceding that Dr. Jacobs analysis refutes that of NIPPC's witness, NIPPC notes that even Dr. Jacobs' analysis supports inclusion of a significant bid adder that must be accounted for in RFP evaluation.

d. NIPPC's analysis did not ignore the possibility for construction cost savings.

Other parties assert that NIPPC's analysis ignored the possibility of cost savings, or cost under-runs. *See, e.g., Staff's Prehearing Brief* at 4, lns. 16-17. This is wrong. 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, 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." *Re Investigation Regarding Competitive Bidding*, OPUC Docket No. UM 1182, Order No. 06-446,

at 13 (2006). Arguments to the contrary lack merit.

e. Cost overruns include latent defects and deferred capital additions.

Finally, the utilities argue that construction cost overruns and latent defects occurring after the initial start-up date are beyond the scope of the proceeding. *See Idaho Power's Prehearing Brief* at 11. This has been the primary response to NIPPC's irrefutable evidence that each of the Oregon utilities have made major capital expenditures shortly after their plants have come online. However, nothing in the procedural ruling in this case limited the construction cost overruns issue to a mere snap shot of the construction costs declared by the utility at the time the plant first started delivering electricity. The utilities were aware of NIPPC's position that cost overruns can spill into the initial years of operation. Furthermore, the utilities possess all of the evidence they might need to respond to NIPPC's position on this point. For example, the utilities could have provided evidence that they have actually accounted for cost overruns occurring in the first few years of operations in past RFPs by allocating to UOG bids expenditures equal to at least 10% of the initial construction costs to account for ongoing construction and capital costs during the first five years of operation. The utilities' failure to produce such evidence compels a conclusion that it does not exist. This risk has been demonstrated to occur for Oregon plants and should be accounted for as a construction cost overrun in RFP evaluation.

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

NIPPC stands by its recommendation for a bid adder to account for heat rate degradation of at least 8.0% above the starting heat rate. *See* NIPPC/100, Monsen/27. As NIPPC explained, 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. No party can seriously dispute that heat rate degradation occurs. *See Staff's Prehearing Brief* at 10 ("as plants age, they become less efficient"); *PacifiCorp's Prehearing Brief* at 17 ("Heat rate degradation reflects the *fact* that a plant's performance ordinarily declines over time." (emphasis added)). PacifiCorp's own witness even testified that an IPP offering a guaranteed heat rate in a tolling service agreement ("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; *see also Staff's Prehearing Brief* at 4 ("such guarantees are not provided for free and such a PPA likely includes an embedded cost for it"). This demonstrates the need for a bid adder to ensure that a corresponding risk premium is embedded into the UOG bid price. *See* NIPPC/300, Monsen/32-33. Use of the original equipment manufacturer ("OEM") projected degradation factor used to sell the generation equipment is inadequate because a prudent IPP would need to build an additional risk adjustment into its bid. *See NIPPC's Prehearing Brief* at 14.

The utilities' critique of NIPPC's nationwide dataset should be rejected because NIPPC also presented evidence that the Oregon utilities' gas-fired plants have experienced a capacity-weighted average heat rate degradation of 10.4%. *See* NIPPC/100, Monsen/27-28; NIPPC/300, Monsen/34-35. This adder could be used instead of the nationwide dataset if the Commission agrees with the critiques of the larger dataset.

Idaho Power complains that NIPPC's analysis of the nationwide dataset does not compare the actual heat rates to the heat rate that the utility assumed would occur when the utility proposed the plant. *See Idaho Power's Prehearing Brief* at 15. However, NIPPC's analysis included that data for three Oregon plants -- Idaho Power's Danskin plant, PGE's Port Westward plant, and PacifiCorp's Gadsby Peakers plant. *See* NIPPC/300, Monsen/27-28. This data demonstrated that heat rate degradation has occurred at a greater rate than assumed at the

time the utilities committed to build those UOG plants. *Id.*

Idaho Power alleges that for the Danskin plant NIPPC improperly compared "two different heat rates – the 'low' and 'high' heat rates—each of which are calculated differently." *See Idaho Power's Prehearing Brief* at 16 (citing Idaho Power/200, Stokes/16).[3] But Idaho Power's assertion is unavailing. According to Idaho Power, for natural gas plants, "the difference between the high and low heat rate is over 10 percent." *See* Idaho Power/200, Stokes/17. Thus, Idaho Power claims NIPPC's figure for the actual heat rate using FERC Form 1 data for Idaho Power's Danskin plant are off by 10%. *See id.*; NIPPC/100, Monsen/28 n.43. This [redacted] NIPPC's testimony that the Danskin plant's [redacted] than expected based on the FERC Form 1 data. *See* Confidential NIPPC/100, Monsen /28 & n.43. Idaho Power's proposed adjustment of 10% to the FERC Form 1 data [redacted]. Furthermore, in a discovery response, Idaho Power provided the heat rate data used at the time of resource selection for the Danskin plant along with the actual plant heat rates. *See* Confidential NIPPC/100, Monsen /28 & n.43; Confidential NIPPC/126, Monsen/1-12. Using these data, which Idaho Power presumably provided on a consistent basis, the Danskin plant's average heat rate has been [redacted] than expected. *See* Confidential NIPPC/100, Monsen /28. Idaho Power's own numbers demonstrate that its Danskin plant has [redacted].

The record demonstrates that heat rate degradation occurs and should be accounted for in RFP evaluation. The evidence supports a heat rate adder to UOG bids.

[3] Idaho Power's critique does not apply to NIPPC's analysis for PGE's Port Westward plant or PacifiCorp's Gadsby Peakers plant.

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

The utilities have failed to refute NIPPC's recommendation for a bid price adder for UOG wind plants of 11.7% based upon publicly available data for PacifiCorp's wind plants and a slightly revised percentage based upon additional confidential information. *See* NIPPC/100, Monsen/31. The Oregon IEs have specifically noted this risk differential for wind capacity factor error at a UOG plant compared to a PPA structure, but have failed to actually account for the risk to ratepayers in bid evaluations. *See* NIPPC/300, Monsen/43-44 (quoting Accion's IE Report on this topic); *see also* Confidential NIPPC/300, Monsen/45-46 (discussing Boston Pacific's conclusions).

In addition to the PacifiCorp data supporting the need for a bid adder, the Commission may now also rely upon the fact that PGE has recently filed a request for rate recovery for increased net variable power costs resulting from lower than expected production for the first several years of operation at PGE's UOG Biglow Canyon wind plant. *See* Direct Testimony of Portland General Electric Company witnesses Mike Niman and Terri Peschka, Exhibit 400, OPUC Docket No. UE 262 (Feb. 15, 2013) (*hereinafter:* UE 262 PGE/400)).[4] PGE's testimony provides yet another example of an Oregon utility passing onto ratepayers the costs of underperformance of a "cost-plus" utility-owned resource. In its rate case, PGE testified: "The Biglow Canyon wind energy forecast previously relied on annual and monthly capacity factors based on a study completed in 2005 for PGE by Garrad Hassan America." *See* UE 262 PGE/400,

[4] NIPPC has moved for official notice of PGE's testimony in its general rate case on this topic. *See NIPPC's Motion for Official Notice; see also State of Oregon v. Bellah*, 242 Or.App. 73, 82, 252 P.3d 357, 362 (2011); *In Re PacifiCorp dba Pacific Power: 2013 Transition Adjustment Mechanism*, OPUC Docket No. UE 245, Order No. 09-409, at 12 (2012) (taking official notice and relying upon contents of documents filed in other proceedings).

Niman-Peschka/9. As PGE's witnesses in the general rate case note, however, an updated forecast "based on a five-year average using PGE's actual generation history at the facility" results in a much lower forecast of production, which PGE proposes to use for setting net variable power costs. *Id.* According to PGE's own testimony, "The updated Biglow Canyon energy forecast increases PGE's initial 2014 NVPC forecast by approximately $2.7 million." *Id.* at 10.

This example proves NIPPC's position. As NIPPC has explained, the UOG wind project passes on all prudent capital costs of the project to ratepayers regardless of actual production. *See* NIPPC/300, Monsen/36-37. Underperformance risk is borne by the ratepayers in the UOG structure. NIPPC/300, Monsen/43. And in this latest example, an increase of $2.7 million per year is a significant cost worthy of a full accounting in RFP evaluation. IPP bidders must incorporate this risk into their bid price. *See* NIPPC/300, Monsen/36-37 . Without a risk adjustment in bid evaluation, PGE could simply ignore the risk for the UOG structure and ask for increased rate recovery at a later date, arguing that it reasonably relied on a reputable wind forecast at the time of resource selection. The utilities have asserted that the history of their wind resources "is simply too limited to support NIPPC's recommendation." *PacifiCorp's Prehearing Brief* at 15. PGE, however, has now testified in its rate case that the five years of history at Biglow Canyon is more than suitable for purposes of increasing net power supply forecasts used to set rates.

This example also demonstrates the flaw in relying solely on the use of a "Capacity Factor Expert" rather than a bid adder for this risk. Again, NIPPC agrees that an independent capacity factor expert should be *required* in all renewable RFPs, but the use of such an expert does not remove the need for bid adders, or a "risk adjustment" in Accion's words. *See*

NIPPC/300, Monsen/46. The expert will merely provide analysis of the best estimate of capacity factor given available information, and will not be able to address the differential in *risk* of a forecasting error between a UOG and IPP project. PGE relied upon a reputable firm (Garrad Hassan) to provide the capacity factor estimates for Biglow Canyon. But the best available forecast proved to be incorrect. There is no assurance that future forecasts will be more reliable and eliminate the *risk* of increased power production expenses for future UOG wind plants. The IE should account for that *risk* with a bid adder for UOG projects.

B. PPA STRUCTURES PROTECT UTILITIES AND THEIR CUSTOMERS FROM RISKS ASSOCIATED WITH CONSTRUCTION COST OVERRUNS, HEAT RATE DEGRADATION, AND WIND CAPACITY FACTOR OVERESTIMATES.

PGE apparently believes that NIPPC has offered no evidence that a PPA structure would offer reduced risk related to cost overruns, heat rate degradation, and wind capacity factor overestimates. *See PGE's Prehearing Brief* at 12 ("NIPPC has refused to produce in discovery a single executed PPA to support its claim that PPAs provide absolute protection from risks that exist in the utility-owned resources."). PGE has also introduced discovery responses that PGE may use to argue NIPPC did not address this issue. *See* PGE/401. PGE is incorrect. The record overwhelmingly compels a conclusion that PPAs typically provide protections for ratepayers with regard to the three risks at issue in this case.

First, PGE appears to believe that IPPs will be able to "re-price" a PPA in the event of a cost overrun, thus negating any benefits the PPA would provide. *See PGE's Prehearing Brief* at 18; PGE/300, Jacobs/34. However, PGE was subsequently unable to point to any PPA it has ever executed that supports this claim. NIPPC/602, Stipulated Exhibit/1. In fact, the record demonstrates just the opposite is the case. NIPPC's witness, Allen Kasper, testified that "a force majeure clause is unlikely to entitle the IPP to a renegotiation of the contract price for the plant's

output if the force majeure event causes a cost overrun or decreased performance." NIPPC/500, Kasper/17. Mr. Kasper also testified, "In contrast, if the utility contracts with an EPC contractor to build the plant for the utility, a force majeure event will never allow the utility to simply walk away from the failed project. Instead, . . . the utility/owner would need to absorb cost increases to complete the project." NIPPC/500, Kasper/18. Unlike Dr. Jacobs, NIPPC's witness *actually reviewed and quoted EPC contracts and PPAs with Oregon utilities* demonstrating his point. *See* Confidential NIPPC/500, Kasper/18-19. PGE has not, and cannot, refute the fact that there is an increased risk to ratepayers with the utility ownership structure because the utility *owns* the project.

PGE also speculates that heat rate guarantees are not a component of the typical PPA structure for a gas-fired plant, which is a tolling service agreement. *See PGE's Prehearing Brief* at 11. This position lacks merit because it is directly contrary to that of both Idaho Power and PacifiCorp. *See* PAC/100, Kusters/14-15; Idaho Power/100, Stokes/13. In fact, the IE overseeing PGE's own RFP also expressly stated that "PPAs do frequently provide heat rate and other operational guarantees . . . ." *See Report of the Independent Evaluator, Accion Group, Portland General Electric Company's 2012 Capacity and Energy Power Supply Resources RFP*, OPUC Docket No. UM 1535, at 17 (Jan. 30, 2013) (*hereinafter: UM 1535 IE Report*)).[5] Moreover, even if PGE were correct, NIPPC's proposal would also apply the adder to any IPP bid that fails to provide a heat rate guarantee. *See* NIPPC/100, Monsen/27.

The record also demonstrates that a PPA structure protects ratepayers from wind capacity factor overestimates. As Oregon IEs have expressly modeled and explained, a lower than expected capacity factor at a UOG plant directly increases costs to ratepayers because ratepayers

[5] NIPPC has requested the Commission take official notice of the Oregon IE report filed in docket UM 1535 during the pendency of this proceeding. *See supra* n. 4.

must pay the same capital and operating costs for a lower amount of output. *See* NIPPC/300, Monsen/43-45. PGE's own rate case testimony fully demonstrates this point. *See* UE 262 PGE/400. In contrast, ratepayers only pay for output that is delivered under the PPA structure. *See* NIPPC/300, Monsen/36-37. Consequently, Accion Group has stated that wind capacity factor risk is "borne by the counterparty in a PPA structure." NIPPC/300, Monsen/43. Somewhat ironically, the utilities have speculated that IPPs could harm ratepayers by delivering *more* power than projected through a capacity factor *underestimate*. *See, e.g., PGE's Prehearing Brief* at 11. Unlike NIPPC, however, the utilities have presented *no evidence* of even a single instance where this speculative harm to Oregon ratepayers has ever occurred. The only logical conclusion is that the utilities "have posed this hypothetical argument as a red herring to try to divert attention from the widely established and well-documented real risk of cost over-runs from UOG wind forecasting over-estimates." NIPPC/300, Monsen/43.

The Commission should reject the notion that PPAs provide no protections when compared to cost-plus utility-owned projects.

C. THE COMMISSION SHOULD ELIMINATE SCORING PENALTIES DEVELOPED BY THE UTILITIES AS A PROXY FOR COUNTER PARTY RISK AND CONSIDER FURTHER REFINEMENTS TO ADDRESS THE CREDIT ADVANTAGE SOLELY PROVIDED TO UOG BIDS.

As NIPPC noted in its pre-hearing brief, the risk of actual damages to ratepayers resulting from counter-party risk 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. PacifiCorp has raised the specter of an IPP abandoning a project after being unable to construct the plant at the cost submitted in an RFP. *See* PacifiCorp/200, Kusters/15 n. 16. However, when pressed to provide actual examples, PacifiCorp provided only one where an IPP was unable to perform after

signing a PPA with PacifiCorp. *See*; Redacted and Confidential NIPPC/601, Stipulated Exhibit/1-2. Even there, PacifiCorp failed to demonstrate that the IPP's abandonment of the project occurred without compensating PacifiCorp for damages. *See* Redacted NIPPC/601, Stipulated Exhibit/1-2 (stating that the dispute was resolved through confidential arbitration). In contrast, PacifiCorp admits that several IPPs have successfully completed construction after winning an RFP. NIPPC/601, Stipulated Exhibit/2.

PacifiCorp also speculates that an IPP providing a heat rate guarantee may choose to abandon the project if it becomes economically efficient to breach the agreement and pay liquidated damages. *PacifiCorp's Prehearing Brief* at 20. But PacifiCorp does not explain how the heat rate guarantee in a Long Term Service Agreement ("LTSA") that it would secure for a UOG project with the OEM mitigates this alleged problem of "economic breach." Nor does PacifiCorp explain how an IPP that owns an underperforming power plant could ever be better off by breaching a long-term PPA. Recent outcomes of Oregon RFPs underscore the difficulty of securing an off-taker for the output of an IPP plant in the Pacific Northwest. *See* NIPPC/400, Collins/8 (noting that only one PPA for a major resource in excess of 100 MW has been executed as a result of an Oregon RFP since 2006). And again, PacifiCorp has provided no examples of where it has actually been harmed by such an "economic breach" – indeed, in the example provided, PacifiCorp receives a liquidated damage payment by the breaching IPP.

The Commission should also not rely on new factual assertions provided through PacifiCorp's legal brief as an attempt to rebut NIPPC's testimony that PPA terms and excess supply largely eliminate the impact of counter party risk on ratepayers. *See PacifiCorp's Prehearing Brief* at 34-35 (averring that an IPP failure can have "profound" consequences not considered by NIPPC and "the California energy crisis was, in part, the result of utilities'

dependence on short-term market purchases"). These factual assertions are not in the evidentiary record and are not officially noticeable. PacifiCorp had the opportunity to cross examine Ms. Collins on these points, but PacifiCorp chose not to. PacifiCorp cannot now pad the record with averments in its brief.

In short, the utilities have failed to demonstrate that the scoring penalties for credit determinations are a reasonable proxy for counter party risk. These scoring criteria serve no purpose other than to drive up the cost of IPP bids in Oregon RFPs without any benefit to ratepayers. *See* NIPPC/400, Collins/11. The Commission should eliminate scoring penalties for credit and consider NIPPC's proposals for further reforms of the RFP process with regard to credit. *See* NIPPC/400, Collins/19-20.

D. COMMISSION STAFF'S CRITIQUE REGARDING "FORECAST" ERROR SHOULD NOT DISTRACT THE COMMISSION FROM THE MERITS OF ADOPTING BID ADDERS FOR UOG PROJECTS.

According to Commission Staff, "this investigation was to focus on risk, and not on assessing if bid evaluation uses the correct expected values for construction cost, heat-rate, or wind capacity." *Staff's Prehearing Brief* at 5. Commission Staff's legal brief even goes on to explain the Commission Staff's distinction with a "coin flip example" and other factual assertions found nowhere in the evidentiary record. *See id.* at 5-8. Although NIPPC objects to the improper inclusion of new factual assertions in Staff's legal brief, it is also important to note that Staff's argument regarding forecast risk is largely a matter of semantics that should not preclude adoption of meaningful bid adders.

The point of NIPPC's proposal for bid adders is that there is a real *risk* that a forecast error will result in increased costs to own and operate a power plant. An IPP must incorporate that *risk* into its fixed-price bid for a PPA structure, while a utility can simply ignore the *risk* in a

cost-plus UOG bid. *See* NIPPC/300, Monsen/3-4. Under the current RFP structure, the IE is supposed to be the neutralizing factor allowing these two very distinct resource types to compete against each other. *See NIPPC's Prehearing Brief* at 3-4. Moreover, the Commission has already determined that a utility has an obvious and inherent incentive to own and place into rate base major resources that emerge from RFPs. *Re An Investigation Regarding Performance-Based Ratemaking Mechanisms to Address Potential Build-vs.-Buy Bias*, OPUC Docket UM 1276, Order No. 11-001, at 5 (2011). Thus a utility has an incentive to underestimate the forecast of costs for the UOG project. This is a real problem that needs to be addressed.

Most importantly, Commission Staff itself recognizes that there is merit to NIPPC's proposal to address this problem through the use of adders. "There may be circumstances where Staff would support developing generic adders using the RFP process as a way to address forecast risk." Staff/200, Procter/24. Staff's preference, however, appears to be for "RFP-specific" adders developed through comment in individual RFPs, rather than generic adders adopted in this investigation. *Id.* Despite Staff's lengthy critique, its proposal is not far removed from NIPPC's proposal for transparent development of adders. Again, under NIPPC's proposal, the utility would have the opportunity to demonstrate a particular adder should be modified with regard to certain bids in a particular RFP. *See* NIPPC/100, Monsen/3-4.

E. THE COMMISSION SHOULD TAKE CORRECTIVE ACTION BECAUSE THE OREGON IE REPORTS CONTINUE TO FALL SHORT OF PROVIDING A COMPLETE ACCOUNTING OF RELEVANT RISKS UNDER GUIDELINE 10(D).

The most recent IE Report to be filed in Oregon fully demonstrates the need for further guidance to Oregon IEs. *See UM 1535 IE Report.* The entirety of the comparison of the risk differential between IPP and UOG bids in that lengthy report is as follows:

> Of particular concern to the IE during the development of the evaluation methodology was the issue of comparing PPA bids to the Benchmark and other EPC bids that may have different risk profiles. A project without firm pricing guarantees for the construction of the facility has different exposure than a project with set capacity pricing for the term of the proposed agreement. The Oregon Competitive Bidding Guidelines require consideration of these risks in the development of the initial and final short list. However, *these risks were accounted for in the design of the RFP since it required fixed pricing for most* ***pre-in service costs*** *of these plants.* Additional non-price scoring adjustments were not necessary with this normalization of the risk profiles between PPA and Benchmark or EPC bids.
>
> The risk of costs during plant operation is a distinct consideration. However, *since most of the cost exposure during the life of the project for PPAs is passed through to the utility*, the risk profile for these costs is similar for both PPAs and Benchmark or EPC projects. Therefore, additional non-price scoring differences to accommodate plant operation cost risks were not necessary. *PPAs do frequently provide heat rate and other operational guarantees, but similar to other risk categories, the Benchmark resource or EPC bids have contractual agreements with equipment suppliers that normalize this risk.* The IE and the PGE evaluation team worked together during the RFP development and during bid evaluation to ensure that any disparities in risk profiles between the types of resources were considered.

UM 1535 IE Report at 17-18 (emphasis added).

This analysis falls far short of the Commission's declaration that it wants "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." *See Re* Order No. 11-001 at 6. The *UM 1535 IE Report* demonstrates that without Commission action Oregon IEs will in fact tend towards a *less* comprehensive accounting of the relevant risks than at the time of Order No. 11-001. Indeed, this most recent IE report provides *no accounting* of relevant risks.

Moreover, the evidence submitted in this docket refutes the apparent conclusion in the *UM 1535 IE Report* that there is *no risk differential* between PPA and UOG structures in PGE's ongoing RFP. The *UM 1535 IE Report* assumed that there is no basis for cost overruns when an

EPC contract exists because EPC contracts provided "*fixed pricing for most **pre-in service costs***." *UM 1535 IE Report* at 17. This assumption is wrong.

The evidence in this docket demonstrates that even with an EPC contract, the *risk remains* for change orders, cost overruns exceeding the EPC contract's damages cap, latent defects or deferred capital additions 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. *See* NIPPC/500, Kasper/10-14, 17-19. The utilities in fact agree with NIPPC on this point. *See PacifiCorp's Prehearing Brief* at 29 ("the Company has not made the claim that a well-drafted EPC contract will protect customers from all contingencies and risks."); *PGE's Prehearing Legal Brief* at 23 ("NIPPC is attacking a straw man. No one has ever suggested that EPC cost guarantees eliminate all risk of cost overruns.").[6] Furthermore, the Commission directly expressed 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." Order No. 11-001 at 6. The *UM 1535 IE Report* is not only contrary to even the position of the utilities, but it is precisely the type of analysis that the Commission has found unsatisfactory.

The *UM 1535 IE Report* also carelessly assumed that the ongoing performance risks for IPP and UOG plants are identical because the heat rate guarantee in a LTSA is equivalent to that in a tolling service agreement. *UM 1535 IE Report* at 17-18. This is also an incomplete accounting of the relevant risks. The *UM 1535 IE Report* overlooks that an LTSA with a heat rate guarantee by the OEM will require the utility to grant the OEM the right to conduct more

[6] On the very next page of PGE's legal brief, however, PGE noted, "PGE proposed to provide a higher score to benchmark resource projects *if* they include an EPC contract with cost guarantees." *PGE's Prehearing Brief* at 24 (emphasis in original).

frequent maintenance shut-downs and capital upgrades. NIPPC/500, Kasper/13-14. As PacifiCorp has acknowledged, a prudent IPP would need to incorporate such incremental costs associated their own heat rate guarantee into the bid price. *See* PAC/100, Kusters/15-16. It is only fair that the IE require the UOG bids to incorporate that increased cost into their bid score as well. If the IE believes that the LTSA provides an equivalent heat rate guarantee to a tolling agreement, the Commission should instruct the IE to provide a full accounting of increased costs resulting from the increased downtime and capital additions required by the LTSA. Those are costs that the IPP must incorporate into its bid, but the UOG bid could ignore without a full accounting by the IE.

The *UM 1535 IE Report* is yet another example of an IE report that has failed to meet the Commission's expectations for a full accounting of all of the relevant risks, as called for in RFP Guideline 10(d). The Commission needs to require a more comprehensive accounting of the risk differential through the use of bid adders to account for the "cost plus" nature of UOG bids.

CONCLUSION

The Commission should find that there is a need for risk adjustments to properly compare IPP bids for a PPA structure with UOG bids in Oregon RFPs. The record compels a finding that IPPs cannot compete on equal footing without requiring the Oregon IEs to properly account for this risk differential. Without a correction, the Oregon RFP process will lose credibility and cease to provide the benefits of a competitive solicitation to Oregon ratepayers. NIPPC therefore respectfully proposes that the Commission revise the Guideline 10(d) analysis by requiring the bid adders and policy directives discussed herein.

RESPECTFULLY SUBMITTED this 11th day of March, 2013.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 11th day of March, 2013, a true and correct copy of the within and foregoing **POST HEARING LEGAL BRIEF OF THE NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION IN DOCKET UM 1182** (electronic service of redacted materials, paper service of confidential material):

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