BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1182

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In the Matter of	)
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PUBLIC UTILITY COMMISSION OF	)
OREGON Investigation Regarding	)
Competitive Bidding	)

REPLY TESTIMONY

OF THE

CITIZENS' UTILITY BOARD OF OREGON

January 14, 2013

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 246

In the Matter of	)	
PUBLIC UTILITY COMMISSION OF OREGON Investigation Regarding Competitive Bidding	)	REPLY TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON

Our names are Bob Jenks and Gordon Feighner. Our qualifications are provided in CUB Exhibit 101.

I. Introduction

CUB appreciates the opportunity to submit Reply Testimony in this docket. Although we chose not to submit Opening Testimony in November 2012, CUB feels it necessary to reply to a number of issues raised by the various parties in that round of testimony.

The Commission has identified four risks to be analyzed in Phase II of this docket.[1] Those risks are:

1. *Cost Over-run and Under-run Risk*
2. *Wind Capacity Factor Risk*
3. *Counter-Party Risk*
4. *Heat-Rate Degradation Risk*

[1] OPUC Order No. 12-324, page 4.

CUB agrees that all four of these risks can significantly alter the bidding process. The Opening Testimony of the utilities largely argues for the status quo with regard to how each of these risks is treated in bid evaluation. NIPPC argues that changes to bid evaluation methodology are necessary to ensure a level playing field for all bidders. To that end NIPPC has developed several bid adders that it proposes be included in the competitive bidding phase to ease the comparison between utility-owned bids and those from independent power producers.[2] Specifically, NIPPC proposes adders for construction cost over-runs, heat rate degradation, and wind capacity factors. NIPPC's proposal also allows for utility-owned bids to be exempted from certain adders under certain circumstances, but places the burden on the utility to prove that an exemption is necessary.

NIPPC argues that adders should be used because independent power producer [IPP] contracts typically reduce the risks to customers from these risk factors; the utilities counter that their construction contracts protect customers from these factors. In both cases the claims are based on the terms of the particular contracts. CUB notes that contract terms can vary significantly. To the degree that adders are required to account for bias in a utility's self-build bid, IPPs should also be required to demonstrate that the risk protection is contained in the contract language. Likewise, if adders are rejected because a utility's construction contract mitigates risks, then the utility should demonstrate the risk mitigation terms of the contract.

II. Discussion of Specific Risks

Each of the risks identified by the Commission must be examined separately.

[2] UM 1182/NIPPC/100/Monsen/3.

A. Construction Cost Over-run and Under-Run Risk

There are benefits to customers for both utility-owned and independent generation projects. Independent bids insulate customers from cost over-runs through contractual obligations and penalties for late project delivery. Utility-owned projects provide no such protections, but customers do benefit from cost under-runs in the form of a reduced overall rate base for the utility. There is certainly a need to address the asymmetry involved in this issue.

PGE endorses an approach of minimizing cost over-run risk by seeking fixed price guarantees from contractors and by careful management of work change orders. The utility proposes a bid adder for construction cost guarantees submitted by contractors.[3] PacifiCorp states that it currently requires fixed-price bids from contractors, adjusts those bids for a number of risk factors, and requires the inclusion of contingency reserves. PacifiCorp recommends that the Commission adopt its approach and sees no reason to significantly alter the bid scoring methodology.[4]

NIPPC proposes a construction cost over-run adder to account for the risk that ratepayers will be held responsible for cost over-runs of utility-owned generation projects.[5] This adder would serve to assign a risk premium to utility-owned projects that reflects the responsibility customers have for cost over-runs. CUB is receptive to NIPPC's argument that customers are fully responsible for a utility's cost over-runs, and therefore there is an inherent risk involved. On the other hand, both PGE's and PacifiCorp's arguments are founded on the utilities' ability to lock in construction costs

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[3] UM 1182/PGE/100/Outama-Bettis-Mody-Hager/21-22.
[4] UM 1182/PacifiCorp/100/Kusters/10-11.
[5] UM 1182/NIPPC/100/Monsen/4.

on self-bid options. CUB recommends that the Commission either adopt NIPPC's adder or require utilities to demonstrate that self-build options do not include significant risks of cost over-runs.

B. Wind Capacity Factor Risk

Independent power producers and utilities have significant incentives to assume differing wind capacity factors when submitting project bids. For utility-owned generation projects, an assumption of a higher capacity factor is beneficial, as these projects are rate-based, so customers are charged for the same level of investment regardless of generation. Customers assume the downside risk of higher prices per unit of energy generated, as well as a reduction in the number of renewable energy credits (RECs) generated by the project. Customers also receive the benefit of lower net power costs if generation exceeds estimates; however, there is no downside risk to the utility in this situation.

Independent power producers, on the other hand, have an incentive to assume a lower capacity factor. There is a loss of revenue to the project if generation is lower than expected; there is also a risk to customers, as higher net power costs and additional REC purchases may be necessary to offset lower generation. When generation exceeds expected levels, however, most power purchase agreements lock the utility in to purchasing the excess generation. This means that net power costs can increase and REC purchases can be greater than expected if the contract cost exceeds the current market price for electricity. This situation leaves customers to bear higher costs, yet increases revenues for the project developer.

Both PGE[6] and PacifiCorp[7] believe that more robust and independent assessments of wind capacity factors can account for the inherent bias in bids from all parties. While capacity factor estimate metrics are certainly improving, CUB believes that utilities have an incentive to forecast wind availability near the highest level of the forecast range, while independent power producers have an incentive to forecast availability near the lowest level of the forecast range. NIPPC proposes an adder that reduces the wind capacity factor of utility-owned projects to account for this fundamental difference.[8] NIPPC claims this is necessary shield customers from the potential for increased costs to customers resulting from lower-than-expected generation. CUB agrees with this approach, although not necessarily with NIPPC's methodology or the actual value of the proposed adder.

C. Counter-Party Risk

CUB acknowledges that there is some degree of counter-party risk involved with independent generation projects. However, CUB agrees with NIPPC Witness Camden Collins in his assessment that no compelling case has been made by the utilities to show that counter-party risk, financial or otherwise, should be a significant factor in bid evaluation.[9] If a sound methodology for assigning values to credit differentials can be developed, CUB would welcome its inclusion in the bid evaluation process.

[6] UM 1182/PGE/100/Outama-Bettis-Mody-Hager/28-29.
[7] UM 1182/PacifiCorp/100/Kusters/10-11.
[8] UM 1182/NIPPC/100/Monsen/4.

[9] UM 1182/NIPPC/200/Collins.

D. Heat Rate Degradation Risk

Heat rate degradation results in a lower energy output for the same amount of fuel input. As such, a generation facility will become costlier and less efficient over its operational life. Assumptions regarding at what rate the degradation will occur can significantly affect the bid prices of generation resources.

IPPs are generally contractually liable for heat rate degradation at their facilities, so the higher expenses that result are already accounted for in initial bids. NIPPC proposes an adder to account for the assumed degradation in heat rate over the operational life of utility-owned bids.[10] NIPPC therefore assumes that utility-owned projects do not already account for heat rate degradation. The testimony of both PGE[11] and PacifiCorp[12] indicates, however, that utility-owned bids incorporate assumptions about heat rate degradation from the plant equipment manufacturer. It is likely that this rate is similar to any assumption that is included in an independent bid, although a more conservative estimate may be used by independent contractors to account for their cost liability. Without additional information relating to how utilities and IPPs account for heat rate degradation, it is impossible to quantify the level of risk.

III. Conclusion

CUB endorses NIPPC's recommendation that a capacity factor adder be applied to utility-owned bids for wind generation. NIPPC's recommendation is a step in the right direction in terms of developing a methodology to correct the inherent differences between utility-owned and independent resource bids. CUB believes that this adder

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[10] UM 1182/NIPPC/100/Monsen/4.
[11] UM 1182/PGE/100/Outama-Bettis-Mody-Hager/18.
[12] UM 1182/PacifiCorp/100/Kusters/12.

would therefore improve the fairness of bid evaluations; however, CUB is not prepared to accept or endorse any specific quantitative adders at this time.

CUB would like to see bid prices that provide greater certainty and shield customers from the risk of being responsible for cost over-runs. To this end CUB recommends either that the Commission adopt NIPPC's construction cost adder or require utilities to demonstrate that self-build options do not include significant risks of cost over-runs.

CUB does not believe that any party has provided sufficient evidence to necessitate a change in the bid evaluation methodology to account for counterparty risk or heat rate degradation risk.

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EXPERIENCE: Provided testimony or comments in a variety of OPUC dockets, including UE 88, UE 92, UM 903, UM 918, UE 102, UP 168, UT 125, UT 141, UE 115, UE 116, UE 137, UE 139, UE 161, UE 165, UE 167, UE 170, UE 172, UE 173, UE 207, UE 208, UE 210, UG 152, UM 995, UM 1050, UM 1071, UM 1147, UM 1121, UM 1206, UM 1209, and UM 1355. Participated in the development of a variety of Least Cost Plans and PUC Settlement Conferences. Provided testimony to Oregon Legislative Committees on consumer issues relating to energy and telecommunications. Lobbied the Oregon Congressional delegation on behalf of CUB and the National Association of State Utility Consumer Advocates.

Between 1982 and 1991, worked for the Oregon State Public Interest Research Group, the Massachusetts Public Interest Research Group, and the Fund for Public Interest Research on a variety of public policy issues.

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Between 2004 and 2008, I worked for the US Environmental Protection Agency and the City of Portland Bureau of Environmental Services, conducting economic and environmental analyses on a number of projects. In November 2008 I joined the Citizens' Utility Board of Oregon as a Utility Analyst and began conducting research and analysis on behalf of CUB.

UM 1182– CERTIFICATE OF SERVICE

I hereby certify that, on this 14th day of January, 2013, I served the foregoing **REPLY TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON** in docket UM 1182 upon each party listed in the UM 1182 PUC Service List by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending one original and one copy by U.S. mail, postage prepaid, to the Commission's Salem offices.

(W denotes waiver of paper service)

(C denotes service of Confidential material authorized)

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