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May 31, 2007

VIA Electronic Mail & U.S. Mail

Public Utility Commission of Oregon
Attn: Filing Center
550 Capitol St NE #215
PO Box 2148
Salem OR 97308-2148

Re: UM 1276; NIPPC Opening Comments

Attached is a copy of NIPPC's Opening Comments in this docket. A hard copy of these comments will follow in the U.S. Mail.

Please call me if you have any questions.

Very truly yours,

/s/ Susan K. Ackerman

Susan K. Ackerman
Attorney for NIPPC

Enclosures

Certificate of Service

I certify that I have this day served the foregoing document upon all parties of record in UM 1276 by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to all parties or attorneys of parties, on the service list compiled by the OPUC.

Dated this 31st day of May, 2007.

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BEFORE THE OREGON PUBLIC UTILITY COMMISSION

UM 1276

In the Matter of	)
	)
Staff's request to open an investigation	)
regarding performance-based ratemaking	)
mechanisms to address potential build-vs-buy bias.	)

OPENING COMMENTS OF THE NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION

Pursuant to the Administrative Law Judge's April 30, 2007, Memorandum in this docket, the Northwest and Intermountain Power Producers Coalition ("NIPPC") submits its straw proposal and opening comments.

<u>Introduction</u>

This docket is one in a related series of dockets opened by the Oregon Public Utility Commission ("OPUC" or "Commission") to examine its policies regarding new generating resources. The dockets followed from the Commission's Docket UM 1066 examination of whether its administrative rule requiring utility resources to be reflected in rates at market should be amended to allow utilities to embed their resources in rates at cost. The Commission put the question of "cost vs. market" on hold pending the result of other related investigations, including an investigation of its competitive bidding guidelines. *In the Matter of an Investigation Into Regulatory Policies Affecting New Resource Development*, Order 05-133, slip op. at 2 (UM 1066, March 17, 2005). The Commission suggested there were good arguments to return to a cost standard for utility resources, but also expressed concern that the cost standard would cause utilities to favor their own resources. This investigation is to consider the use of performance based ratemaking to "offset utility bias in favor of owning its own resources." *Id.*

The parties' straw proposals identify three sources of utility bias inherent in non-utility power purchases: (a) the threat of debt imputation on utilities by rating agencies, (b) the fact that RFP evaluations do not adequately capture the risk avoidance attributes of purchased power agreements (PPAs) to utility consumers, and (c) the fact that ownership provides the utility with income opportunity, but PPAs do not. One party's proposal attempts to address rate and risk sharing impacts that may flow from adopting any of the utility incentive proposals made here.

NIPPC submits that the Commission should do what it reasonably can to eliminate the utility bias and incentivize utility purchases and not ownership. Oregon law provides that it is among the "duties, functions and powers of the [Commission]" to develop policies that:

> […] eliminate barriers to the development of a competitive retail market structure. The policies shall be designed to mitigate the vertical and horizontal market power of incumbent electric companies, prohibit preferential treatment, or the appearance of such treatment, of generation or market affiliates and determine the electric services likely to be competitive. […]

O.R.S. 757.646(1). While Oregon's direct access statutes are aimed at developing retail competition, effective retail competition in the absence of a competitive wholesale market is ephemera. There can be no retail choice without competing providers from which to choose. It is within the Commission's power to adopt policies that eliminate the bias in favor of utility resources and thereby encourage a healthy wholesale power market because these policies will assist in creating the conditions for a competitive retail market and in mitigating the market power of incumbent electric utilities. Oregon's consumers will benefit from resource acquisition protocols that encourage healthy wholesale markets.

NIPPC's Straw Proposal

The parties exchanged straw proposals addressing the bias issue prior to the filing of comments. NIPPC's straw proposal is Attachment A to these comments. These comments are intended to further develop and support NIPPC's straw proposal.

1. Background

Non-utility purchases offer distinct advantages to consumers that utility owned resources cannot. The advantages that IPPs bring to utility consumers are that IPPs absorb risks associated with resource development that the utility rarely or incompletely absorbs under traditional cost-based ratemaking approaches.[1] Because PPA advantages are not quantified directly in the utility's RFP evaluations even under the Commission's new competitive bidding and integrated resource planning guidelines, the result is that the utility benchmark resource can appear to be a more cost effective resource for consumers than it may actually end up being, which is a built in bias in favor of the utility resource.

Among the risks that IPPs typically absorb are the following:

- The IPP, not the ratepayer, assumes the capital-cost risk (i.e., the risk of cost overruns in a fixed PPA bid).
- The IPP, not the ratepayer, assumes technology risk – e.g., that a thermal resource will perform consistent with the PPA specifications for the unit's heat rate. That is, if the actual heat rate is less than that predicted the ratepayer is kept whole to the predicted rate and not exposed to incremental gas commodity costs. An IPP assumes similar technology risk with a wind farm, assuring that its turbines perform as advertised.
- The IPP assumes the O&M cost risk as this is "locked in" under the PPA. As such, ratepayers are not exposed to cost overruns relative to maintaining operations.
- The IPP assumes availability risk. That is, if the unit is available less than the target availability stipulated in the PPA, then ratepayers are relieved of their fixed payment obligation commensurate with the reduction in availability. With respect to wind power, the IPP assumes the risk of the wind regime, equipment reliability, i.e., the project's capacity factor.

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[1] Utilities absorb these risks only in the event of prudence disallowances, which may not be timely. Also, demonstrating imprudence can be difficult for intervenors.

- IPP projects may offer a lower cost-of-capital as an IPP may have a stronger balance sheet than the purchasing utility, and moreover, is capable of leveraging the project more aggressively with low-cost debt financing (e.g., 80-20 vs. the typical 50-50 utility capital structure).
- The IPP assumes decommissioning costs normally associated with siting permit requirements.

Accion-Boston Pacific, the Independent Evaluator (IE) selected by Oregon to evaluate PacifiCorp's recent request for proposals, noted these distinct advantages to non-utility IPP purchases:

> [U]nder cost-plus ratemaking for Benchmark Resources, all risk is assigned to Oregon ratepayers within the bounds of prudence. This is in sharp contrast to the substantial before-the-fact assignment of risks to bidders achieved through transaction contracts such as pay for performance PPA.
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> One of the most important innovations of competitive reform, in general, and competitive bidding, in particular, is that risks have been increasingly assigned before the fact to power suppliers; that risk allocation to power suppliers is most often achieved through a pay-for-performance PPA (purchased power agreement). Not only does this take risk off the shoulders of the ratepayer, but it also helps to minimize risk because it assigns risk to a party that is in a position to do something about it—that is, to mitigate that risk. This assignment of risks through a PPA to parties in a position to mitigate risk is greatly advanced as a power supplier then re-allocates risks though its subcontracts for engineering, procurement, and construction (EPC), project finance, operation and maintenance (O&M) and fuel supply.

See, The Oregon Independent Evaluator's Assessment of PacifiCorp's 2012 RFP Design, Part I, pp. 17-18, April 13, 2007. The IE went on to propose that there were two ways to take the risk avoidance attributes into account in bid evaluations. First, the utility could quantify the risks (or benefits) and add that value to (or subtract it from) the utility's benchmark resource for evaluation purposes. The second approach the IE proposed was to require that the utility's benchmark resource be held to the same risk assignment standards as PPAs are held. *Id.,* at pp. 22-23. The IE strongly preferred the second approach: requiring the utility to be held to the same risk assignment standards as are PPAs.

Like the IE, NIPPC prefers an accounting of PPA risk avoidance benefits upfront in the RFP resource evaluation phase. In a perfect world, NIPPC would prefer an approach that requires the utility to "live" with its bid, as the IE suggested, over an approach that requires quantification of risks avoidance benefits.

The IE's second approach (requiring the utility to live with its benchmark resource "bid") is one that the Commission has already considered and is apparently prepared to reject. In UM 1066, the Commission considered how utility resources could be included in rates at "market" rather than cost. In that docket, Staff and the utilities questioned how such a regime could be fairly administered in the context of cost-based regulation. Utilities do not trust "market" approaches to valuing utility resources in rates because when utility resources perform well (i.e., better than "bid"), those advantages will be passed along to the utility customer and not retained by the shareholder. In other words, under standard regulatory treatment the utility shareholder cannot count on receiving the benefit relative to market of its resource decisions, among other complications. The Commission appears to agree with those concerns. The IE's preferred approach (requiring the utility to live with its bid), however logical, poses many of the same complications that concern the Commission and parties to UM 1066.

The first approach that the IE referenced, that risk avoidance attributes of PPAs be specifically quantified and either added to or subtracted from the utility's benchmark resources for bid evaluation purposes, may be difficult to undertake in practice. The Commission's competitive bidding guidelines required the IE to "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." *In The Matter Of An Investigation Regarding Competitive Bidding*, OPUC Order

No. 06-446, slip op. at 12 (Guideline 10.d.). In the PacifiCorp RFP, the IE qualitatively analyzed the varying risks and advantages of PPAs and utility benchmark resources, but did not go so far as to quantify them. Indeed, in practice it will be difficult for either the IE or the utility to quantify the comparative risks and benefits of PPAs and rate-based utility resources in the context of an RFP or IRP evaluation. This difficulty puts the non-utility resources at a distinct disadvantage because the risk avoidance attributes of the non-utility resource cannot be recognized directly or comparably with the utility resource. NIPPC therefore proposes that the risk avoidance attributes of utility bids be "quantified" by proxy and evaluated upfront in the RFP evaluation process, as follows.

2. NIPPC's Proposal

NIPPC proposes that the UM 1182 competitive bidding guidelines be reopened and supplemented with a requirement that bid evaluations explicitly recognize the risk avoidance attributes that IPPs provide. NIPPC proposes that the risk avoidance benefits of non-utility purchases be recognized by applying a 10% discount to the present value (PV) of delivered power[2] of any IPP bid in the RFP as evaluated by the utility and the Independent Evaluator when a utility benchmark resource is involved. The discount is for bid evaluation purposes only, and does not either reduce the payments to the IPP if selected or directly raise consumer rates. How the 10% discount is applied would depend on the bid evaluation technique employed. For instance, if the cost comparison estimation (of the bid vs the other option - be it market or self-build) is undertaken on a projected hourly basis or modeled on a monthly basis, then the cost of the IPP bid is lowered in that context by 10% for each measurement period (hourly, monthly, or even annually). When the adjusted cost by period is then summed over the entire period of

[2] The definition of "delivered power" may vary by resource type.

review (most likely 20 years) the resulting PV evaluation will have automatically adjusted for the 10% discount. As long as the time horizon of the IPP resource bid and the utility benchmark resource are comparable and do not otherwise skew the evaluations, the 10% discount should account for the unique benefits of PPAs.

The 10% discount is a proxy value instead of an actual value. It does not specifically measure the risk avoidance benefits of each purchase contract. As suggested earlier, it will be difficult to actually quantify the risk avoidance benefits of purchases. This is because such an analysis would be heavily dependent upon assumptions, and the assumptions would each be subject to challenge. Therefore, quantifying risk avoidance benefits in an RFP evaluation process would be difficult, contentious, and time consuming, without actually leading to the achievement of a policy goal of the Commission's: a healthy wholesale market that delivers resource variety and options to Oregon's consumers.

NIPPC asks the Commission to conclude that a 10% discount to PPAs in bid evaluation is a reasonable policy for it to adopt because it enhances the value of the PPA option to consumers. The proxy value is necessary to initiate a policy change that is consistent with the Commission's statutory authorities. Oregon law permits the Commission to make this decision, and energy policy in Oregon has made similar decisions in the past. The 10% discount (or advantage) has been used before in the Pacific Northwest to recognize the value of alternative resources such as conservation. Both the Northwest Power Act and Oregon statutes provide this explicitly. *See*, Pacific Northwest Electric Power Planning and Conservation Act, 16 U.S.C. § 839a(4)(D); *also* O.R.S. § 469.631(4)("[T]he present value of the delivered energy costs of an energy conservation measure shall not be treated as greater than that of a non-conservation energy resource or facility unless that cost is greater than 110 percent of the present value of the delivered energy cost of the non-conservation energy resource."). These statutes advanced a discrete approach to encouraging investment in conservation resources, as a 10% discount to PPAs would encourage those resources.

3. Other Considerations

The NIPPC proposal described above would tend to mitigate one bias against non-utility resources and advance other state policy goals regarding energy markets. It does not address other biases or disincentives to acquiring non-utility resources, such as the possibility of having rating agencies impute debt to the utility's balance sheet or depriving the utility shareholders of earnings opportunities. NIPPC is interested in advancing other thoughtful and measured policy initiatives that would address the imputed debt and shareholder value issues.

Other Straw Proposals

In NIPPC's view, it is not reasonable to debate that regulated investor-owned utilities have a bias in favor their own resources, except in rare circumstances. As well, it is also not reasonable to debate that the utility investors' earnings expectations are at the bottom of that bias. Many resources that would otherwise be in the interests of utility customers specifically or society generally cannot provide the utility investor with earnings or other financial incentives, and these facts often require the sort of policy intervention that regulators have considered in the past and should consider here. Absent policy intervention by regulators to deal with imputed debt or lack of earnings opportunities associated with PPAs, the non-utility resource is unlikely to be able to overcome the utility's bias in favor of its own resources, any more than demand-side resources were able on their own merits to overcome the utility bias stemming from lost sales. NIPPC views the utilities' income opportunity and debt imputation proposals in the same light, as described below.

1. PacifiCorp's CIM/pp Proposal

PacifiCorp proposes that the Commission allow utilities to capitalize expenditures in the capacity portion of new PPAs of a year or longer duration, using policies the Commission has previously employed to incentivize conservation investment. PacifiCorp proposes specific limits on the scope of this approach, such as limiting its applicability to new PPAs and to PPAs of one year or more duration, and finally by limiting its applicability to a capped capacity portion of the PPA.

PacifiCorp argues, and NIPPC agrees, that this approach would have two advantages that address issues raised in this docket. The first is that it may adequately address the debt imputation issue, thus mitigating a significant disincentive towards PPAs, because the capacity portion of the PPA has been effectively "rate based." The second advantage is that the approach allows the utility to earn on the capacity portion of the PPA, thus mitigating the disincentive (from the utility perspective) of lack of utility earnings potential from PPAs.

The PacifiCorp proposal raises three concerns for NIPPC. The first is that the approach would make IPP bids look less cost effective in bid evaluations than the bids would otherwise be because it effectively adds a second return to the cost of the IPP resource. IPPs bid resources into RFPs with the IPP's required return already assumed in its bid price. The PacifiCorp proposal adds to the cost of the IPP bid, and thus may tend to skew RFP evaluations towards any utility benchmark resource and away from the PPA. One way to address this concern would be to not include the potential utility earnings "cost" of an IPP bid when evaluating the IPP in an RFP comparison. This would keep the playing field level between the IPP and the utility for bid evaluation purposes.

The second concern has to do with the timing of rate changes when compared to the timing of PPAs. The PacifiCorp proposal would have to be monitored to assure that the PPA is reflected in customer rates only as long as the PPA is in effect. PacifiCorp suggested as much in its proposal, stating that the utilities could "amortize prudent PPA expenditures, plus AFPPA for capacity portion of PAA, over life of PPA." This would correctly coordinate the benefit to the customers of the PPA power supply with the cost to customers of the PPA by timing rate recovery to the term of the PPA. This issue suggests that the PPA rate base effect get reflected in rates in annual power cost updates, rather than in rate cases, as the annual update would permit closer timing of the costs and benefits of the PPA from the customers' standpoint.

NIPPC's third concern is that the PacifiCorp proposal for "rate basing" the capacity portion of the PPA should not deprive customers of the risk avoidance attributes that independent power brings to the customer, as this defeats the value to end users of an independent and competitive wholesale market. Therefore, PPAs should not be rate based by the utility unless some conditions are met, such as (1) unit availability of the generator is pre-selected at an annual (percentage) level, (2) construction and O&M cost risks are assumed by the IPP, and (3) relevant permitting requirements have been properly met by the IPP, among other conditions.

2. <u>PGE's Income Opportunity Proposals</u>

PGE proposes a direct approach to incentivizing utilities to engage PPAs. PGE proposes a portfolio management fee, structured as a percentage of the net cost of contracts that are held by the utility, which would compensate the utility for effectively managing a portfolio of purchase contracts and offset the earnings opportunity loss the utility experiences from not building. The management fee could be applied to individual contracts, or to an entire portfolio. PGE also proposes that an adder, which would vary depending on the specific type of contract involved, could be simply applied to each mid- to long-term purchased power contract. The adder would include the utility's authorized rate of return (ROR), the capacity component of the contract, and the terms of the contract with respect to price(s) and term and vary depending on the amount of management or risk assumed by the utility in managing the contract.

As a way of mitigating a utility bias against PPAs due to the inability of the utility to provide shareholder returns from them, NIPPC thinks that the PGE proposal has merit. It also appears that the PGE proposed management fees can be calibrated as the Commission deems reasonable at the beginning of each contract (or by portfolio), which provides the Commission with flexibility to time the inclusion of a management fee in rates with the life of the contract. A disadvantage is that this PGE proposal does not directly address the debt imputation issue, which PGE addresses separately.

3. PGE's Imputed Debt / Imputed Equity Proposal

PGE proposes to neutralize the detrimental effect on utility financial ratios of imputed debt by imputing an equal amount of equity for ratemaking purposes. PGE proposes that this calculation would be made during the general rate case process and would be based on the competitively-procured contracts included in the utility's power cost forecast for the next calendar year.

The PGE proposal could mitigate Wall Street's imputed debt impact on utility earnings by calculating and allowing the utility an equivalent amount of equity using the S&P approach. It should therefore mitigate a "bias" for utility resources because it removes a penalty that utilities perceive for their shareholders as associated with purchased resources.

NIPPC could support the PGE approach as a way of removing a disincentive (and thus mitigating a bias) against purchased resources, although it is probably not enough standing alone to incentivize purchases over utility resources.

4. ICNU's ROE Offset Proposal

ICNU expresses concern that the income opportunities proposed in this docket to eliminate or mitigate the bias against non-utility owned resources would tilt the relative risks between the utility and customers, and thus proposes an equity offset to maintain that balance. ICNU proposes that the Commission consider adopting an adjustment to the utilities' return on equity ("ROE") to hold ratepayers harmless if the Commission provides the utilities economic incentives to enter into purchase power agreements. ICNU states that the ROE adjustment should capture the value of the risk that is shifted from the utility to ratepayers.

NIPPC appreciates what ICNU is attempting to do here, which is to protect consumers from rate impacts that may occur if the Commission agrees to incentivize non-utility purchases. NIPPC agrees that the impact on customers of the incentive proposals made in this docket is an important consideration for the Commission. However, removing utility biases and incentivizing purchases should advantage consumers ultimately as the least cost resources over their life cycles are acquired for them and as risks are shifted to the IPP and away from the consumer. The ICNU proposal adds another disincentive to non-utility purchases: any positive benefit from the PPA to the utility is offset by the ROE deduction, leaving utilities, IPPs, and end users in the same position that they are today. This does not advance the goal that the Commission values: a robust and competitive wholesale market that provides customers with resource variety or short and long term resource optionality.

Conclusion

The Commission has initiated this docket with the explicit intent of addressing the self-evident and deleterious consequences of utilities' self-build bias. The sustained viability of a robust wholesale market in Oregon rests on finding constructive solutions to this dilemma. Stakeholders have presented the Commission with several thoughtful straw proposals that collectively offer potential for correcting utility bias thereby protecting the benefits consumers see through power purchase agreements.

NIPPC believes that its proposal to the Commission to incorporate a 10% proxy value to its competitive procurement rules will substantially counter the utility self-build bias.

For all the reasons stated in these comments, NIPPC requests that the Commission adopt NIPPC's proposal and such other proposals (or elements thereof) as necessary to mitigate utility biases in favor of utility owned resources.

DATED this 31st day of May, 2007.

Respectfully submitted,

NORTHWEST AND INTERMOUNTAIN
POWER PRODUCERS COALITION

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Attachment A
NIPPC Straw Proposal
(May 16, 2007)

NIPPC proposes the following approach for removing utility bias in favor of resource ownership.

1. Re-open UM 1182 to provide that, in RFP evaluations, the positive benefits that IPPs provide to consumers in the form of risk avoidance is explicitly recognized. These risks were described in NIPPC's April 19, 2007, Straw Proposal. The benefits ratepayers receive can be recognized by applying a 10% discount to the net present value of delivered power of any IPP bid in the RFP as evaluated by the utility and the Independent Evaluator. (The definition of "delivered power" may vary by resource type.)

The discount is recognized for bid evaluation purposes only, and does not either reduce payments to the IPP or get reflected in consumer rates. The chosen discount, 10%, is reasonable because (a) it would be impossible to precisely quantify in advance the risk absorption benefits IPPs bring to utilities and consumers, and (b) a 10% discount has been used before in the Pacific Northwest to recognize the value of alternative resources such as conservation and QF purchases. The Accion-Boston Pacific IE Report on PacifiCorp's recent RFP recommended that these IPP risk avoidance attributes be recognized by requiring the utility to live with its "benchmark bid" as IPPs are. While NIPPC prefers this approach as well, NIPPC does not recommend it here because such an approach is unlikely to find a place in Oregon policy.

2. NIPPC is open to using the PacifiCorp approach to "rate basing" PPA capacity payments, as described in the utility's April 19 proposal, if pre-conditions are met. These pre-conditions would be aimed at assigning risks of an IPP contract as follows:

- Unit availability of the generator is pre-selected at an annual (percentage) level
- Significant construction risks are assumed by the IPP
- O&M cost risk is assigned the IPP
- The IPP must ensure that relevant permitting requirements have been properly met

Rate basing the capacity portion of an IPP contract also entails other considerations. Capitalization is usually conducted through rate cases. If rate cases are spread out across time, one consideration is whether rate basing sends appropriate price signals to customers. If the utility does not either file for frequent rate cases or has some regulatory vehicle through which the capacity values of the IPP contracts can be updated, the amount of capacity value actually rate based may not reflect the true value of the cost incurred to the utility for engaging in the contracts. This frequency issue could be resolved by an annual adjustment vehicle. Additionally, failure to adequately adjust capacity values could raise debt imputation issues if the utility signed new IPP contracts but did not have a regulatory vehicle through which their overall long-term debt is updated to reflect such actions.

PacifiCorp suggested in its April 19 paper that additional incentive mechanisms could be linked to the concept of rate basing the capacity portion of the IPP contracts. NIPPC remains interested in incentive mechanisms that are well designed, equitable to all parties, and contain a substantially high probability of success. We therefore encourage PacifiCorp to continue a dialogue on such items.

3. Both the 10% discount used for IPP bid evaluation purposes and the ability of the utility to earn a utility rate of return on PPA capacity payments has value to consumers because together these mechanisms provide the utility (and thus consumers) with an incentive to acquire IPP resources in the near- to mid-term. By enabling the utility to enter into PPA transactions of varying resource type and duration, utilities and their ratepayers can effectively benefit from a diverse portfolio of least-cost resources that can satisfy their needs with reduced risk.

4. Whatever regulatory construct the Commission adopts should be reviewed after five years to assure it effectively addressed the utility self-build bias while providing consumers with minimal risk and thereby more affordable electricity.