BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1276

In the Matter of	)
	)
An Investigation Regarding Performance-based Ratemaking Mechanisms to Address Potential Build-vs.-buy Bias.	)))
	)

NORTHWEST AND INTERMOUNTAIN POWER PRODUCERS COALITION REPLY COMMENTS

Pursuant to OAR 860-013-0035 and the schedule agreed by the parties, Northwest and Intermountain Power Producers Coalition ("NIPPC") submits these Reply Comments.

I. INTRODUCTION AND BACKGROUND

A. Preceding Matters

This docket is the fourth in a related group of dockets the Commission opened to re-examine and refresh its resource planning and acquisition policies. The Commission's reexamination is timely as it follows more than a decade of significant change in electric wholesale markets, including the establishment in this region of significant non-utility wholesale generators and innovation in electric energy technologies. Added to these changes are growing concerns about climate change and how it will affect Oregon electric consumers' choices and costs. All the dockets are geared towards assuring that the state's electric consumers have access to the full range of resource alternatives and providers, now and in the future, so that energy needs can be met at the best combination of cost and risk.

In two dockets, the Commission revised its integrated resource planning rules and its competitive bidding guidelines. See, *In the Matter of an Investigation into Integrated Resource Planning Requirements* (Docket No. UM 1056), Order No. 07-002 (January 8, 2007); *In the Matter of an Investigation Regarding Competitive Bidding* (Docket UM 1182), Order No. 06-446 (August 10, 2006). The third docket, UM 1066, was substantially completed but held in abeyance pending the outcome of Dockets UM 1056, UM 1182 and this docket, UM 1276. *In the Matter of an Investigation Into Regulatory Policies Affecting New Resource Development* (Docket UM 1066), Order No. 05-133, p. 2.

This docket is the next step for the Commission to take in its progressive review of its resource acquisition policies. Resolving this docket will also allow the Commission to finally resolve the ultimate question in Docket No. UM 1066: whether utility resources should be included in rates at cost or market. *Id.* The Commission appears to prefer to return to a cost basis for utility owned resources for ratemaking purposes, but expressed concern that utilities would have a bias toward owning, rather than purchasing, resources when cost-based rates are used. *Id.* ("We are still concerned, however, that the use of the cost standard will cause a utility to favor its own proposed resources.") As such a bias may tend to deprive consumers of access to the full range of energy alternatives that exist, the Commission is right to address it.

NIPPC submits that a healthy utility resource portfolio is one that displays a significant level of diversity. All parties appreciate the importance of a diverse portfolio of different types of resources and resource technologies. Another important diversity characteristic, though, is diversity of types and duration of resource *ownership*. The Commission recognized this in its recent integrated resource planning docket, UM 1056. In its Order in that docket, the Commission directed utilities to assess the relative advantages and disadvantages of owning

resources compared to renting them. Order No. 07-002, p. 22 (guideline 13). Customers are advantaged when resource ownership is diversified as this particular kind of diversity gives utilities and customers access to different types and durations of resources without committing excessively to any single resource or technology, as utility ownership requires.

The subject of this docket, then, is to consider the use of performance based ratemaking to "offset utility bias in favor of owning its own resource." *Id.* Once a utility has examined its resource needs and options in an IRP, and tested purchase alternatives through a well structured RFP, how does the Commission assure itself that biases do not inappropriately skew resource choices towards the utility's own resources?

B. <u>This Docket</u>

The parties developed a number of proposals to address the utility ownership bias and filed these proposals with opening comments in May, 2007. At the June 26, 2007 workshop, the Commission expressed interest in the NIPPC ten percent bias proposal ("Ten Percent proposal") and the PacifiCorp conservation incentive mechanism for purchased power proposal ("PacifiCorp CIM/pp proposal"). The Commission also expressed an interest in a single consolidated proposal, if feasible.

Following the June 26 workshop, the parties consulted extensively among each other and participated formally in two additional workshops. No consensus was achieved. Instead, the parties clarified their preferences regarding each others' proposals, asked and responded to data requests, and developed and shared other options. Staff developed an alternative proposal by drawing on both the NIPPC Ten Percent proposal and the PacifiCorp CIM/pp proposal (the "Staff proposal") and the discussions of the parties. In NIPPC's opinion, the Staff proposal represents the best single consolidated proposal that could be achieved among the parties.

Because Staff's proposal incorporates NIPPC's preferences regarding an incentive mechanism to a substantial extent, and because it represents the best single consolidated proposal in this docket, NIPPC supports it with only a few select differences, addressed below.[1]

These comments are thus organized in the following sections: (1) the policy issues before the Commission, (2) NIPPC's support for and discussion of the Staff proposal and the parties' variations on it, (3) the alternative proposals, including the NIPPC Ten Percent alternative and the PacifiCorp CIM/pp proposal, if the Commission does not adopt the Staff proposal, and finally, (4) NIPPC's response to parties' opening comments.

II. POLICY QUESTIONS

NIPPC stated in its opening comments that it is not productive to debate whether investor-owned utilities are biased in favor their own resources, or whether utility earnings expectations are at the bottom of that bias. NIPPC Opening Comments, p. 8. Many resources that would otherwise be in the interests of utility customers specifically or society generally do not now provide the utility with earnings or other financial incentives, and these facts require the sort of policy intervention that Oregon regulators have considered in the past and should consider here. Absent policy intervention by regulators, non-utility resources may not 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. Indeed, most parties in this docket accepted the Commission's premise that the issue is not whether there is a bias, but how to overcome it while keeping the interests of utility customers in mind.

The basic policy questions for the Commission in this docket are these: (1) whether utilities should be financially rewarded for entering into purchased power agreements ("PPAs");

[1] NIPPC's preferred version of the Staff proposal is Attachment A to these comments.

(2) under what circumstances and limits should financial rewards apply to PPAs; (3) what financial incentive is sufficient to achieve the goal of mitigating utility preferences for their own resources; and (4) most importantly, how do any utility financial rewards benefit utility customers?

Obviously, NIPPC agrees with the fundamental proposition that it is appropriate for utilities to receive some financial reward for entering into PPAs. Utility financial rewards, however, must be consistent with the interests of utility customers in cost-effective and reliable utility service. The Commission's basic task in this docket, therefore, is finding the right balance between addressing the utility shareholder need for profit and the customers' need for the optimal selection of resources, now and in the future. In NIPPC's view, the Staff proposal comes closest to achieving this important balance, and NIPPC therefore supports it with the reservations described below.

III. THE STAFF PROPOSAL

Staff's proposal rests on a few key underpinnings. First, the proposal accepts the existence of a utility earnings-related bias in favor of its own resources. Second, the proposal accepts that PPAs provide benefits to consumers by absorbing certain costs and risks that would otherwise be borne by customers if the utility were to own the resource for forty years. Risk and cost shifting onto a PPA sponsor occurs at bid and contract time, and is usually apparent on the face of the bid or contract. Third, the proposal implicitly acknowledges that it is difficult if not impossible to quantify the *relative* value of risks and costs absorbed by a PPA when contrasted with utility resources. This is because the Commission cannot know precisely what future risks and costs might be imposed on utility customers from long-lived utility resources. This makes it extremely difficult to fairly evaluate the true benefit of PPAs to customers at bid evaluation time.

And last, the Staff proposal suggests that it is appropriate for customers to pay in rates for a financial incentive to utilities for entering into eligible PPAs, *provided that* customers truly benefit from the risk absorption characteristics that a PPA can provide.

While NIPPC has some differences with the Staff proposal, NIPPC supports the essential approach. If accepted by the Commission, the Staff proposal would help address a particular policy gap that disadvantages non-utility generation to the detriment of Oregon utility customers. It represents sensible policy intervention that could enable the Commission to close out its four policy dockets regarding resource planning and acquisition. Nevertheless NIPPC remains concerned that Staff does not go far enough to address utility bias.

A. Summary of the Basic Staff Proposal

Staff proposes to allow utilities to recover in rates a financial incentive in the form of an adder of ten percent calculated on a pre-tax basis and applied to Oregon's share of the forecasted costs, excluding fuel costs, of an "eligible" PPA. To be eligible for the incentive, the PPA must (1) be selected in a competitive bidding process that conforms to the UM 1182 guidelines, (2) be in lieu of a utility ownership option, (3) demonstrate that it will absorb costs or risks that a utility's customers would otherwise be required to absorb, (4) be for quantities of 25 MW or more and have delivery terms of three years or longer, and (5) be contractually associated with specific assets by unit.[2]

Staff appropriately coordinates its incentive mechanism with the UM 1182 competitive bidding guidelines such that the two policies support each other. The cost of the incentive will not be considered in determining initial and final short lists from a competitive RFP although the incentive will be considered in any Commission acknowledgement proceeding of an RFP. The

[2] Staff proposes other conditions; they are not all repeated in this summary description.

Independent Evaluator in an RFP will provide a formal recommendation to the Commission about the eligibility of a PPA for the incentive, and the utility may refer to the Financial Accounting Standards Board Financial Interpretation 46(R) to support its request for the incentive. The incentive may be recovered by the utility in a rate case or in an annual power cost adjustment filing. Last, Staff proposes to limit total incentives paid to one percent of the utility's authorized retail revenues, at which time the mechanism will be reviewed for extension or potential modification.

B. Issues

NIPPC and the Joint Utilities[3] each filed variations of the Staff proposal, reflecting differences on select issues. These issues are addressed below in order of their appearance in the basic Staff proposal, not in order of importance.

1. Basis for the Ten Percent Incentive. Staff's ten percent adder was based on NIPPC's original straw proposal. In its original proposal, NIPPC posited that PPAs absorb risks (when compared to utility resources) that consumers would otherwise bear. Risks that can be shared upfront through PPA negotiation include such things as capital cost overruns, fixed O&M increases, technology risks, such as heat rate increases or wind availability, fuel costs, and increasingly, the risks of carbon cost adders, among many other areas of future resource risk (and costs) that a utility and an Independent Power Producer (IPP) could address in a bid and subsequent PPA negotiation. To the extent the risks are assigned to the PPA, they are not risks that the utility or its customers will be required to bear. By contrast, if the utility owns the resource, the risks are borne by customers within the confines of prudence reviews.

[3] Joint Utilities are PGE, PacifiCorp, and Idaho Power.

By way of example, assume that a utility stated capital cost for a 518 MW combined cycle combustion turbine (CCCT) is $732/kW.[4] If as the plant was built unexpected construction cost overruns exceeded fifteen percent of budgeted costs, then the actual capital cost would be $742/kW. In this case, the overrun would result in a $68 million increase in the present value of the revenue requirement (PVRR) for this project, costs that the utility customer will likely bear unless a case for imprudence regarding the overruns was successfully made in a future rate case. Other costs may not be apparent at first. It is the heat rate of the CCCT unit that determines its efficiency. If the heat rate degrades over time or turns out to be only five percent less than advertised, then the effect on PVRR is an increase of $79 million over the life of the project.

Similar calculations can be analyzed for wind resources, where incorrect assumptions can similarly result in rate impacts. With wind power, performance largely hinges on an accurate estimation of wind speed. If this is misjudged, the capacity factor of the wind farm will be dramatically affected to the detriment of tens of millions of dollars. For example, for a typical 50 MWa wind farm, overestimating the capacity factor by twenty percent can result in $21 million in additional costs to consumers over twenty years.[5]

If the utility owned the resources cited in these examples, the risk of cost increases will be borne by the consumer unless the Commission holds the utility to its resource assumptions in all future rate cases in which the resource is reflected utility plant. This is unlikely in Oregon

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[4] Assumptions regarding the example CCCT were drawn from Chapter 5 (Resource Options), Tables 5.2 and 5.3 (including the August 2007 Errata) of PacifiCorp's 2007 IRP. The deltas in PVRR assume a 20-year cost recovery period, matching a 20-year PPA term.

[5] Robert D. Kahn, *Is There A Role for IPP in RPS Compliance, Financing and Marketing?* November 14, 2007 Presentation to Renewable Energy Seminar and Teleconference Series sponsored by the American Council On Renewable Energy (ACORE) in collaboration with the Renewable Energy Resources Committee of the American Bar Association (SEER Section), & Renewable Energy Committee of the Energy Bar Association, at http://www.acore.org/renewableenergyinfo/includes/resource-files/robert%20d%20kahn%20presentation.pdf

due to existing regulatory policies. Yet these same risks and costs are uniformly borne by the IPP developer in the case of a PPA. The Independent Evaluator in PacifiCorp's RFP noted a significant advantage of a PPA was its ability to assign risks upfront:

> [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 relative value of PPA and utility-owned resource risk absorption characteristics could never be explicitly quantified unless the Commission is prepared to state definitively and up front what utility resource costs will be allowed in rates *and* whether these initial cost determinations may change over time. The Commission does not make such commitments, and therefore it is up to consumer advocates and Staff to challenge costs in each rate case on prudence grounds when the costs change from initial estimates. The risks and costs of PPAs, however, are stated in the contract and thus are known at the outset. Under these circumstances, it is reasonable to assume that there is a value from risk avoidance that attaches to a non-utility PPA, but that in contrast does not attach to a utility investment.

NIPPC had therefore proposed that the Commission attach a ten percent value to PPA risk absorption qualities and apply that value to PPAs upfront at bid evaluation time.[6] Ten percent is a reasonable estimate of PPA cost benefits over time from absorbing risks and also is the same value that Oregon policy has applied to conservation resources. *See,* 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.").

Staff's proposal creatively redirects this "ten percent" concept and uses it for a utility financial incentive. Staff proposes to allow the utility that enters into an eligible PPA to recover the ten percent value[7] as an explicit financial reward for engaging in the PPA. As was true for NIPPC's original proposal and for the current Staff proposal, "ten percent" is not a calculated number. Indeed, it is not possible to calculate the precise value of risk avoidance benefits. Ten percent is a policy judgment for the Commission.

Industrial Customers of Northwest Utilities ("ICNU") question whether utilities should receive *any* incentive on PPAs. ICNU Opening Comments, pp. 1-2. ICNU appears to be the only party that does not believe any incentive is needed or warranted to mitigate utility bias against PPAs. NWEC states that ten percent is too rich an incentive and may actually create a bias *against* utility owned resources. NIPPC finds this argument difficult to understand. Because the Staff proposal does not capitalize PPA payments, add them to rate base and amortize

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[6] The NIPPC Ten Percent Proposal, dated September 13, 2007, is attached as Attachment B to these Comments.

[7] Staff proposes that ten percent is calculated on a pre-tax basis and applied to Oregon's share of the non-fuel related costs of a PPA, with an annual true up for differences between forecasted and actual costs.

them like a traditional utility investment, a ten percent adder (pre- or post-tax) applied to actual costs does not generate utility earnings at any level close to the earnings the utility could expect from a traditional utility investment, so it is difficult to see how the Staff adder could bias the utility against its own resources. NWEC's alternative is to limit the incentive to two-to-three percent after tax until the nature and magnitude of the utility bias to be mitigated is measured. NWEC Alternative Proposal (December 21, 2007). p. 1-2. This sort of adder might be theoretically true from the standpoint of millions of investors who are choosing between many utility-type investments, but it does not address the mindset of the utility executives who make actual investment decisions.

The observations and judgments of ICNU and NWEC are, like Staff's and NIPPC's, borne of the same limitation all parties have in this matter: no one really knows what if anything will incentivize the utility except the utility itself. In deciding whether and to what extent to financially reward utilities for PPAs, the Commission will be making a policy call based on its best judgment. This judgment will be similar to previous judgments Oregon has made regarding energy resource policy and will be based on the Commission's responsibility to assure that customers continue to have access to the diversity of resources and flexibility of terms available to the utilities. The concerns of NWEC and ICNU stem from concerns that customers not pay excessively for their utility service, and NIPPC understands the concern. The eligibility criteria the Staff proposal imposes on the incentive should provide the Commission and parties comfort that the policy judgment about an incentive will genuinely advantage customers.

2. Should the Incentive Be Offered on a Pre- or Post-tax Basis? Staff proposes that utilities earn a ten percent pre-tax adder on Oregon's share of eligible PPA costs, excluding fuel costs, with an annual true up for differences between forecast and actual PPA

costs. Staff, p. 1. If the adder is calculated on a pre-tax basis, then taxes will effectively reduce the incentive to something closer to six percent. NIPPC and the Joint Utilities both propose that the adder be awarded on a post-tax basis, so that the utilities actually recover the full ten percent on an eligible PPA. NIPPC Final Proposal, p. 1; Joint Utilities Version of Staff Proposal, p. 1.

This issue is another matter for the Commission's judgment. In the past, the Commission has had the view utility incentives are only incentives when the utility itself perceives it to be so. *In re Electric Utility Incentives for Acquisition of Conservation Resources* (Docket No. UM 409), 1992 WL 465765 (Or.P.U.C.), p. 11. ("As the parties correctly note, a mechanism can only be an incentive if the entity sought to be encouraged views it as an incentive."). NIPPC is therefore influenced by the statements of the utilities[8] in this regard, that a six percent after-tax adder is insufficient to capture the attention of utility executives who are considering the promotion of self-build resources and the tangible shareholder advantages they offer. Establishing a meaningful threshold capable of altering behavior is critical if the Commission is to be successful in addressing utility bias for self-built and owned resources.

3. Must a PPA Have Been Selected in a Competitive Solicitation? Staff and NIPPC propose to require a PPA to have been selected from a competitive solicitation in order to be eligible for the incentive. Staff, p. 1; NIPPC p. 1. Joint Utilities propose that any PPA is eligible for the incentive (if it meets other eligibility criteria) even if it was not acquired in a UM 1182 solicitation. Joint Utilities, p. 1-2. The difference arises from an eligibility criterion that Staff, NIPPC, and the Joint Utilities agree upon: PPAs eligible for the incentive are those with quantities 25 MW or greater and terms of three years or longer. The UM 1182 bidding guidelines do not require a competitive solicitation for resources that size; rather, UM 1182 only requires a

[8] Made in workshop conversations.

competitive solicitation for "major resources", or resources with quantities of 100 MW or greater and terms of five years or longer. Order No. 06-446, p. 3 (guideline 1). Joint Utilities on the other hand argue that requiring an RFP as a condition of the incentive means that the Commission is effectively modifying its UM 1182 guidelines in this docket by extending them to smaller sized resources. Joint Utilities, p. 2.

The Commission's bidding guidelines do not prohibit competitive solicitations for resources smaller than the "major resource" size and term threshold. The bidding guidelines merely require it for major resources, leaving open the possibility that competitive solicitations may be used for smaller resources. The issue in this docket is not whether the Commission is modifying its bidding guidelines, but whether utilities should be permitted to earn a financial incentive on certain PPAs. Offering a financial incentive to utilities for certain eligible PPAs is a judgment call for the Commission. It is reasonable for the Commission and consumer advocates to want the incentive to apply to high quality PPAs such as those tested by a rigorous RFP process overseen by an IE. The Commission would be best able to judge the quality of the PPA if it were selected in such a competitive solicitation.

From NIPPC's standpoint, requiring a competitive solicitation as a precondition of incentive eligibility reinforces the importance of bidding and measurably increases the prospects of the utility actually choosing an IPP to meet its resource needs. NIPPC's interest on behalf of its members is to encourage a business climate that attracts investment in IPP resource development, thus helping to assure that the non-utility resource continues to be available in this region. NIPPC urges the Commission to support the use of an RFP as a condition of utilities achieving a financial reward.

4. Must a PPA Be In Lieu of a Utility Benchmark Alternative? Staff proposes that a PPA must be selected in lieu of a utility ownership option in order to be eligible for the incentive. Staff is reviewing whether a self-build option should be required to enable a comparison of relative costs and benefits of PPAs. Staff Proposal, p. 1 (n 4). Joint Utilities propose an alternative, that "[t]he PPA must respond to a resource need that could be met through a PPA or a utility ownership option." Joint Utilities, p. 2. NIPPC would not impose as a condition for the incentive that an explicit ownership option competes with a PPA. NIPPC Proposal, p. 1.

The purpose of this docket is to examine whether performance based ratemaking is needed to eliminate the utility bias for owning, rather than purchasing, resources. It therefore seems logical that the incentive would be available only in those cases where the utility must actually choose between a viable and specific utility-owned resource or a purchased resource, as that choice is what may be influenced by a utility bias. NIPPC nevertheless does not favor imposing the "in lieu of ownership" requirement because such a requirement may itself cause unhelpful behavior. The concern here is that such a requirement may unintentionally encourage utilities to mock up hypothetical resources in order to secure the incentive for a non-utility resource that is otherwise eligible for the incentive. The hypothetical utility resource would unnecessarily complicate RFPs by adding more subjects for analysis and potentially defeating good PPAs when the hypothetical option looks good, even if it is not real. Finally, utility bias in favor of utility ownership is a function of decades of cost-plus regulation that influences how utility executives view investment generally. In NIPPC's view, the incentive should seek to mitigate that particular ownership bias by fostering in utility executives the knowledge that purchases also present opportunities for financial reward.

5. <u>How Should The Commission Judge Whether a PPA Demonstrates Adequate Risk Avoidance to Justify the Incentive</u>? The fundamental premise underlying Staff's proposal (and NIPPC's variation of it) is that it is fair to award a financial incentive to utilities which enter into eligible PPAs because non-utility resources provide utility customers with many advantages. Non-utility resources provide utilities and the customers they serve with resource diversity, which includes not just types of resources, terms, and pricing options, but also diversity in types and terms of resource ownership. They also provide utilities and customers with resource flexibility and options that strengthen resource planning and acquisition. PPAs help maintain a viable non-utility wholesale market because they financially support non-utility resources and tend to secure them to this region during their contractual terms. Finally, but most importantly for purposes of this incentive discussion, PPAs allow the utility to assign resource risks and costs to the PPA sponsor that would otherwise be borne by the utility customers. This is the advantage that the Oregon Independent Evaluator attributed to PPAs in its report on the PacifiCorp 2012 RFP. *See*, p. 9, above. Risks and costs that are subject to negotiation and absorption by a PPA counter party are such things as construction cost risk, O&M cost risk, unit availability risk, technology risk, fuel costs, or among many other potential performance and cost risks. PPAs that demonstrate risk absorption should be eligible for the utility incentive.

NIPPC proposes that the Commission evaluate applicability of the incentive as follows. The Commission should permit the utility to request application of the incentive at RFP acknowledgement time. Only PPAs that are otherwise eligible using criteria from the Staff proposal may be incentivized. The utility's request for the incentive should be supported by identifying those aspects of the bid/PPA that the utility believes justify the incentive because risk has been shifted, in whole or in part, from the utility. The utility may identify any PPA risk-

shifting attributes that it deems relevant to warrant application of the incentive, such as (by way of example and not limitation): capital cost risks, fixed O&M risks, fuel cost risks, technology risks (heat rate performance, wind speed, geothermal reservoirs, etc.), plant availability, carbon cost risks. The utility may support its request with results from its IRP, the RFP, Financial Accounting Standards Board Financial Interpretation 46R (*Consolidation of Variable Interest Entities)*, or any other evidence the utility deems relevant.

This approach provides the utility latitude to identify characteristics that merit the incentive, without unduly restricting future negotiations. The IE will provide the Commission with a formal recommendation about application of the incentive based on the risks identified by the utility as being borne by the PPA counterparty. The Commission may make its judgment at RFP acknowledgement time based on the utility's application, the IE's recommendation, and input of stakeholders in a public meeting.

6. Capping Total Incentive Award and Incentive Review. Staff proposes that total incentive payments to the utility in any single year be limited to one percent of the utility's authorized retail revenue in the previous calendar year. Staff, p. 2. Staff further proposes that the incentive be reviewed for extension or modification under two circumstances: (a) when total incentives reach the one percent level, and (b) within three years of the date an incentive is first included in the utility's rates. *Id*. NIPPC supports the total incentive limit as well as the three year trigger for review of this policy. A utility incentive for non-utility purchases would be new policy ground for the Commission. Because it is new policy, the Commission should re-examine it for its effectiveness. The review triggers proposed by Staff are reasonable.[9]

[9] The Commission may want to revisit the cap and raise it if this program is successful. New generation costs are escalating at an impressive rate, as carbon-mitigation costs may escalate, and the Commission may consider a higher cap to be warranted.

7. Imputed Debt Issues. Staff proposes to require the utility achieving an incentive on a PPA to annually report its financial metrics, including any discernible effects on imputed debt calculations or credit ratings. Staff, p. 2. Both the NIPPC and Joint Utility version of the Staff proposal contain this same requirement. The prospect of a credit rating agency(ies) imputing debt to the utility's balance sheet when evaluating the utility's creditworthiness was often cited in the parties' comments and discussions as one expression of utility bias. Yet, the impact of imputed debt on customers and the utility was not clear. The Staff approach seems to be a workable approach for addressing the debt imputation issue at this time. Since presumably a single PPA is not likely to jeopardize the utilities' credit ratings, access to capital, or stock price, the Commission should address these financial matters in general rate cases.

IV. THE OTHER, ALTERNATIVE BIAS PROPOSALS

A. Introduction

Earlier in these Reply Comments, NIPPC noted that many proposals had been submitted to address the utility bias to build. Among these proposals was NIPPC's Ten Percent proposal and PacifiCorp's CIM/pp proposal. Because NIPPC believes that the Staff alternative just discussed represents with modification the best approach to the issues in this docket, NIPPC generally supports Staff. Nevertheless, if the Commission determines not to adopt the Staff proposal, then the following comments address the NIPPC and PacifiCorp proposals, as requested by the Commission at the June 26 Workshop.

B. The NIPPC Ten Percent Proposal

Earlier in this docket NIPPC offered an alternative proposal to address utility ownership bias. NIPPC's proposal (the Ten Percent proposal) was filed with the Commission and served on

the parties on September 13, 2007.[10] The September 13 Ten Percent proposal was changed from NIPPC's original straw proposal on mitigating bias, although the purpose and effect of the proposal had not changed. NIPPC had originally proposed that in any UM 1182 RFP in which a utility benchmark resource is an option, non-utility bids should be granted a ten percent discount applied to the present value of the cost of the bid. The purpose of the discount was to apply a proxy value to bids for the risk avoidance attributes that IPPs bring to utilities and consumers but that cannot be directly quantified. The ten percent discount would apply for purposes of RFP evaluations only and would neither add to the cost of the IPP bid nor directly increase consumer costs in rates.

In the September 13 version, NIPPC redirected the ten percent proposal to make it more consistent with the Oregon statutory approach to comparing demand- and supply-side resources in integrated resource planning. Instead of a direct discount applied to the present value of the cost of each bid, NIPPC proposed that in any RFP in which a utility benchmark resource is competing with IPP bids, the present value of the cost of eligible IPP bids will not be treated as greater than the present value of the cost of the utility benchmark (in effect, are presumed to be equal to the cost of the utility resource) *unless* the cost of the IPP bid is greater than 110% of the present value of the cost of the utility benchmark resource. Bid(s) are eligible for the presumption only if the bid demonstrates that it will provide risk avoidance benefits to the utility and its customers. Because the Commission will have the counsel of an IE in any RFP in which there is a competing utility benchmark resource, the Commission would rely on the judgment of the IE to establish whether the IPP bid demonstrates sufficient risk avoidance attributes to warrant application of the presumption. Risk avoidance attributes that provide benefits include,

[10] A copy is attached as Exhibit B.

but are not limited to, such things as construction cost risk, O&M cost risk, unit availability risk, technology risk, or any other performance or cost risks that utility customers might otherwise be required to absorb and that the IE believes are significant.

The NIPPC Ten Percent proposal would create a rebuttable presumption at the time of RFP bid evaluation in favor of eligible bids that meet the 110% threshold. In other words, (1) if the IE concluded that a bid(s) demonstrates that it will provide significant value to utilities and customers by absorbing risks that the utility or customers would otherwise be required to absorb if the resource were owned by the utility, and (ii) if the present value of the cost of the bid is no greater than 110% of the present value of the cost of the competing utility benchmark resource, then there would be a rebuttable presumption that these bids have "won" the RFP.[11] The rebuttable presumption is not a prudence determination and does not constitute pre-approval of the RFP or any resources selected from it. The utility would still be able to select its benchmark resource under these circumstances, but the utility would be required at the time of RFP acknowledgement and at the time of a prudence review to justify why the benchmark resource was selected over market bids that are within 110% of the cost of the utility resource. The IE would have the opportunity to advise the Commission about the utility's selection, and the Commission may reach its own conclusions with the benefit of a much deeper record at the time of prudence review.

The NIPPC straw proposal was intended to address a specific bias in favor of utility resources that appears at RFP evaluation time when there is a competing utility benchmark resource. This bias is due to the difficulty of calculating the relative values of risks and risk

[11] If more than one bid is eligible for the rebuttable presumption, then the utility may select among those bids using other criteria relevant to the utility's resource needs.

avoidance benefits that utility and non-utility supplies provide and of applying those values in an RFP evaluation. NIPPC's Opening Comments supported the original NIPPC straw proposal on that basis and on the basis of the Commission's existing statutes and its goals regarding resource acquisition as expressed in all the related dockets: integrated resource planning (UM 1056), competitive bidding (UM 1182), and its docket regarding new resource development (UM 1066). *See,* NIPPC Opening Comments (May 31, 2007), pp. 3-8. NIPPC does not repeat those comments in detail here, but refers the Commission to them.

C. The PacifiCorp CIM/pp Incentive Proposal (And the NIPPC Variation)

In Opening Comments, NIPPC stated that the lack of utility investor earnings from purchasing power supplies was the basis of utility bias favoring utility owned resources. *Id.,* p. 8. The NIPPC Ten Percent proposal addressed a particular limitation in the RFP evaluation process, but did not address the utility earnings issue. NIPPC therefore indicated support for sensible policy intervention by the Commission to mitigate the earnings bias. The PacifiCorp Revised CIM/pp proposal (dated December 21, 2007) is geared specifically to the utility earnings aspect of utility bias.

The CIM/pp mechanism would reward utilities for prudent PPAs by allowing the utility to earn a return on the PPA much as a utility would earn on a regulated capital asset. The mechanism allows utilities to capitalize the net present value of certain PPA expenditures using the utility's average cost of debt. PPA expenditure eligible for capitalization are capacity or other fixed payments identified in the PPA, or if no such payments are identified, a proxy "capacity" amount calculated using the Standard and Poor methodology for calculating PPA capacity payments. Except for wind resources, which may be capitalized at ninety-five percent of the total cost of the PPA, capacity costs eligible for capitalization are capped at fifty percent of

the total costs of the PPA. PacifiCorp proposes to permit the utilities to recognize an AFUDC-type expense (allowance for funds used for purchased power agreements, or AFPPA) calculated on a post tax basis from the date the PPA is executed until the PPA expenditures are reflected in rates. Utilities are then allowed to recover the incentive by amortizing the capitalized portion of the PPA, plus AFPPA, over the term of the PPA and earning the utility's allowed rate of return (calculated on a pre-tax basis) on the unamortized balance.

NIPPC credits PacifiCorp with an inventive proposal that is similar to incentive mechanisms the Commission used in the past. As a mechanism for addressing the earnings bias, as well as the imputed debt issue, PacifiCorp's approach would certainly accomplish both tasks. However, the proposal provides shareholder awards at levels that most other parties in the docket were unwilling to accept. NIPPC therefore does not support the PacifiCorp mechanism. If the Commission determines to adopt the PacifiCorp mechanism, however, then NIPPC prefers its version of the mechanism, filed on September 13, 2007. In the sections that follow, NIPPC addresses the differences it has with the PacifiCorp approach.

1. Size and Term Threshold. PacifiCorp's CIM/pp proposal would apply an earnings incentive to PPAs with delivery terms of three years and quantities of 25 MW or more, with no requirement that the resource be selected in an RFP.[12] In two PacifiCorp orders, the Commission expressed support for the use of short term purchases as "bridging strategies" to mitigate risks that may come from volatile fuel prices (in the case of natural gas costs) or carbon cost risks (in the case of conventional coal resources). The Commission criticized PacifiCorp's 2004 IRP final action plan because it did not adequately analyze the benefits to customers of delaying large scale thermal plant (coal) investment through the use of short term purchases or

[12] Unless the resource were a "major resource" under the UM 1182 bidding guidelines.

demand response programs, and additionally criticized the company for not analyzing the value of transmission investments that would enable short term purchases compared to transmission investment that utility owned resources. *In the Matter of the 2004 PacifiCorp Integrated Resource Plan,* Order 06-029, pp. 51, 56-57. The Commission also rejected PacifiCorp's UM 1208 RFP because it did not take into account the Commission's 2004 IRP Order guidance on the use of bridging strategies, including short term purchases. *In the Matter of PacifiCorp's 2012 Draft Request for Proposals,* Order 07-018, p. 5.

PacifiCorp may have proposed that its CIM/pp mechanism apply to short term purchases not selected in an RFP because these Commission orders stress the importance of short term purchases as bridging strategies. NIPPC agrees that bridging strategies are important and can reduce overall risk/costs to consumers and the utility both. Short term purchases as bridging strategies, however, are only one aspect of resource diversity that the Commission should want to incentivize. As NIPPC indicated earlier, utility portfolio diversity includes diversity in resource ownership, not just the types and durations of resources. *See,* pp. 2-3, above. The Commission's PacifiCorp IRP and 2012 RFP orders, however, do not address utility incentive mechanisms, what resources should be the focus of any incentive, and how best the incentive should be structured. The orders thus do not compel a result that applies an earnings incentive to short term purchases procured without the benefit of an RFP. If the Commission's only policy interest in this docket were to provide financial rewards to utilities for prudent operations that involve non-utility resources, then perhaps applying the incentive to even short term purchases without an RFP requirement is in order. However, as previously indicated, NIPPC thinks it should be a policy objective of the Commission to encourage a robust non-utility wholesale

market in the region, as this is what is required to bring options and resource diversity to consumers in the first instance.

The practical effect of incentivizing short-term purchases without also requiring these resources to be selected in a competitive solicitation would be that the utilities would choose a rolling series of small, short-term (less than five years) purchases without any market test provided by a competitive solicitation.[13] In other words, by explicitly incentivizing purchases with durations less than the five-year RFP minimum without also requiring an RFP, the Commission may be inadvertently undermining the RFP process itself.

NIPPC's version of the CIM/pp incentive would limit availability of the incentive to major resources, as defined in the UM 1182 guidelines, thereby reinforcing the Commission's competitive bidding guidelines. Alternatively, if the Commission is otherwise interested in the PacifiCorp CIM/pp incentive, then the Commission could apply the incentive to PPAs at the three-year/25 MW threshold as PacifiCorp proposes, but require an RFP as an eligibility condition of the incentive, similar to the Staff proposal.

2. Specific Assets vs. System Sales. PacifiCorp's proposal would permit a "system sale" to be eligible for the CIM/pp incentive. PacifiCorp CIM/pp Proposal, p. 2 ("If a specific asset is contractually defined in the PPA, the seller or another third party is the owner of the asset associated with the PPA."). NIPPC would preclude system sales from being eligible for the incentive. NIPPC CIM/pp Proposal, p. 2 (to be eligible for the CIM/pp incentive, the purchase "must identify, as the source of the PPA supply, specific asset(s) by unit(s), and the

[13] Since the UM 1182 RFP guidelines were adopted in Oregon, and similar policies were adopted in Utah, the utilities have initiated 99 MW resources, acquired without competitive bidding because 99 MW is just below the 100 MW major resource threshold. *See,*e.g., Glenrock Wind Energy Project, Rocky Mountain Power Press Release, dated July 17, 2007 (posted at http://www.rockymtnpower.net/Press_Release/Press_Release75653.html).

seller or another third party must be the owner of the asset(s) for the duration of the contract; "system sales" as contracted in normal utility practice are not eligible for the CIM/pp incentive.").

A system sale is an undifferentiated power purchase from an entity (not necessarily a power producer itself) that can pool a variety of resources, including arbitraged purchases from other entities, into a sale. System sales are routine, ongoing occurrences for utilities to meet short term resource and other operational needs. These purchases have many advantages for both the utility and the customer, and so they raise the question of why these arrangements need to be incentivized. The question is valid because they will occur regardless of whether the Commission rewards the utility for them or not. These types of purchases also do nothing to support the development and health of a competitive IPP market, which depends upon a business climate that helps justify IPP investment in generating plant.

What the Commission should want to incentivize from a policy standpoint are purchases from IPPs with specific resources that can be managed *for* the utility. These are the sorts of resources that would not be available to utilities but for IPP investment and ownership, typically in response to a competitive solicitation. IPP owned and operated generating units are the foundation of the market that provides utilities and customers with resource options, and they should be encouraged through the Commission's policies.

3. The RFP Process. The PacifiCorp proposal does not require that a purchase be selected in an RFP to be eligible for the CIM/pp incentive, while NIPPC does require it. See, NIPPC CIM/pp Proposal, p. 2 (the purchase "must have been chosen in a competitive solicitation in which the portfolio modeling and decision criteria used to selected the final short-list of bids was consistent with the modeling and decision criteria used to develop the

utility's acknowledged IRP Action Plan.").[14] For the reasons just discussed in section IV.C.1, of these Reply Comments, NIPPC believes the RFP process should be encouraged for policy reasons, and therefore believes the incentive should be available only to resources selected in RFPs under the UM 1182 guidelines.

NIPPC accepts the proposition that an earnings incentive is necessary to eliminate the bias utilities have for utility-owned resources, but the incentive will admittedly impose costs on consumers that would not be there otherwise. Therefore there must be demonstrable value for the customer dollar. In light of this impact, the Commission will want to assure itself that the CIM/pp incentive is applied to the best possible options that were selected in an open process such that customers benefits from the incentive. The RFP process by virtue of the fact that it is transparent and fair assures that a variety of resource providers will have the opportunity to compete to serve the resource need. The process reveals to utilities, customers, stakeholders, and the Commission the full range of resources and delivery terms that are available. In effect, RFPs "stress test" IRP planning assumptions, enabling utilities to develop the resource portfolios that will best minimize cost and risk to utilities and consumers over time, consistent with reliable utility service. Requiring an RFP before the incentive applies would give the Commission reasonable assurance that the resource selected is worthy of the incentive, or alternatively if a utility resource is selected, that it was prudently selected. NIPPC therefore favors application of the CIM/pp only to those resources selected in an RFP.

NIPPC is aware of the Commission's reservations about the viability of using the RFP process for some resources. Order 07-018, p. 6. ("We note that competitive bidding may not be

[14] PacifiCorp would also require the resource to be consistent with IRP planning results under IRP Guideline 13(a). PacifiCorp CIM/pp Proposal, p. 2.

the appropriate mechanism to acquire all resources that may be part of the best cost/risk portfolio.") In that instance, the Commission's concerns were primarily related to demand-side RFPs. Demand-side RFPs might be more difficult to run in an expedited fashion, as demand-side resources by their nature are often very site-specific and time consuming to develop and implement. Meanwhile, it is probably correct that recent RFPs to date have been fairly involved processes, but that need not necessarily be the case. Moreover, given the added costs to customers entailed in adding an incentive to utilities contracting for PPAs, it is only logical to spend the time undertaking a rigorous RFP for resources to which an incentive may apply. Further experience with the UM 1182 guidelines may result in a more streamlined process for the utilities and bidders as all participants become "seasoned" to the process. And, the utilities may run expedited, single source RFPs, such as wind-only or CCCT-only RFPs.[15] NIPPC encourages the Commission to rely on the RFP process, and to reward utilities with incentives for resources selected in the RFPs.

4. Treatment of Incentive Costs in RFP Evaluation. PacifiCorp and NIPPC have differing approaches to regulatory and rate treatment of CIM/pp costs at RFP evaluation time. PacifiCorp proposes that the costs of the CIM/pp incentive be included in the cost of the bid during RFP short-list acknowledgement time, but not during general RFP evaluation time. PacifiCorp CIM/pp Proposal, p. 3. NIPPC proposed an alternative depending on whether the Commission also adopted NIPPC's Ten Percent proposal. NIPPC CIM/pp Proposal, p. 3.

The practical difficulty with the PacifiCorp proposal to include the cost of the CIM/pp incentive in bid costs at the time of bid evaluation is that the incentive effectively "doubles up" the investor return embedded in the cost of a PPA. As NIPPC noted in its Opening Comments,

[15] The UM 1182 bidding guidelines do not require all-source RFPs. Order 06-446, p. 4.

when IPPs submit bids in response to a utility's RFP, the IPP bid price already includes the return that the IPP needs in order to sustain its business (and the transaction). Allowing the utility to earn a return on the PPA on top of the IPP's return increases the cost of the PPA option, and this makes PPAs look more costly in any RFP evaluation when compared to the utility benchmark resource, thus decreasing the odds that an IPP could "win" an RFP. *See,* NIPPC Opening Comments, p. 9. However, if there is no utility benchmark resource competing in an RFP with market bids, then the PacifiCorp approach is workable, as the incentive would not disadvantage any bidder relative to the utility option in an RFP evaluation. In any RFP in which there is a competing utility resource, however, adding this cost to the market bids will disadvantage bidders, regardless of whether the cost is evaluated during general RFP evaluations or at the time of RFP short list acknowledgment.

If the Commission adopts the CIM/pp mechanism, then NIPPC recommends that the Commission not consider the cost of the CIM/pp *at all* in RFP evaluations in which there is a competing utility benchmark resource. PacifiCorp's analysis of the cost of the CIM/pp incentive demonstrates that the incentive would impose noticeable costs on consumers over the life of the PPA. The cost may be justified to the extent that the PPA has been shown to bring comparable and offsetting risk avoidance benefits to the utility and its customers. However, adding the cost at RFP evaluation time erodes the prospect of a competitively procured IPP option altogether, thereby defeating the stated purpose of this docket.

5. Intermittent Resources. PacifiCorp proposes that, for wind resources, capacity costs may be calculated up to a cap of ninety-five percent of the net present value of wind expenditures. PacifiCorp CIM/pp Proposal, p. 3. NIPPC's version replicates this exception, but would add that, for other renewable resources, the utility should be permitted to

capitalize PPA expenditures proportionate to the relative level of fixed costs to total costs typical for that type of resource. NIPPC CIM/pp Proposal, p. 3. Renewable resources other than wind may also be high fixed cost resources, and failure to permit capitalization of these resources at the same rate that a utility would capitalize costs for a similar utility investment would exacerbate the bias in favor of utility investment, rather than purchase.

6. Summary of the CIM/pp Proposals. The CIM/pp proposal did not capture enough interest among the parties to warrant its adoption, and therefore NIPPC does not support either the PacifiCorp CIM/pp or even its own version of the CIM/pp. If the Commission remains interested in the CIM/pp proposal, however, then NIPPC encourages the Commission to adopt its version of the proposal.

V. REPLY TO PARTIES' OPENING COMMENTS

The industrial customers (ICNU) argue against incentives to the utility to enter into PPAs because the Commission "should not require customer paid incentives in order for the utilities to do their jobs." ICNU, p. 6. Instead, ICNU argues for penalties if the utility fails to acquire least cost resources and alternatively an ROE offset if the Commission adopts incentives. Id., pp. 10, 13-16. NIPPC believes that ICNU has a point. With regard to short term (less than three years), purchases that utilities make routinely as a way of balancing loads or bridging time periods between when new resources are needed and can be acquired, NIPPC agrees that these transactions are normal utility business and need not be explicitly incentivized. Mid- to long-term (three years or longer) resource acquisitions, though, present a greater difficulty for utility shareholders as the earnings losses can become significant. These resources are the very ones that IPPs are ideally suited to provide at reduced risk to utilities and utility customers. As well, these are the types of transactions that will improve the financial and business stability of non-

utility generation in the region. For all of the active proposals in this docket, NIPPC encourages incentives that apply to longer term resources (three years or longer) that were selected in a competitive solicitation.

NIPPC does not support ICNU's idea of an ROE offset as a condition of the achieving an incentive, however, as an offset would negate the very thing that the Commission should want: eliminate utility bias in favor of utility investment.

VI. CONCLUSION

The Commission has two opportunities in this docket. The first is a practical one: it is the opportunity to have fully considered all issues presented in this and the other, related dockets regarding resource planning and acquisition policies and to resolve them in a mutually reinforcing way. The second opportunity is to take a measured step towards addressing the utility ownership bias that the Commission has already recognized and thereby better reduce customer risks in a highly unpredictable and volatile energy market. Because NIPPC believes that the Staff proposal (with NIPPC's variations) is best tailored to providing utility executives with a discrete financial incentive for IPP owned resources that benefit utility customers, NIPPC requests that the Commission adopt the NIPPC version of the Staff proposal, as described in these comments.

DATED this 29th day of January, 2008.

NORTHWEST AND INTERMOUNTAIN
POWER PRODUCERS COALITION

/s/ Susan K. Ackerman
Susan K. Ackerman, OSB 831382
Attorney for NIPPC
9883 NW Nottage Dr.
Portland, Oregon 97229
susan.k.ackerman@comcast.net

Attachment A

NIPPC FINAL PROPOSAL
UM 1276
Investigation Into Performance-Based Ratemaking Mechanisms
December 21, 2007

Type of Mechanism: Utility incentive

Incentive level: 10 percent adder, calculated on a post-tax basis[1], on Oregon's share of the total costs of an eligible power purchase agreement (PPA)

Basis: The 10 percent adder serves as a proxy for the risk mitigation value of PPAs, based on a similar value applied to conservation resources for determining cost-effectiveness.[2] The Commission explicitly recognized that the 10 percent discount accounts for the value of conservation in reducing risk and uncertainty.[3] However, in the case of an eligible PPA the utility would actually receive a 10% incentive in rates.

Eligibility Criteria:

1) Only new PPAs and renewals as of the date of the Commission's authorization of the incentive are eligible.
2) The PPA must be selected in a RFP conducted under the Commission's competitive bidding guidelines (Order No. 06-446).[4] The utility may fulfill its RFP requirement by using expedited or resource-specific RFPs.
3) The PPA must demonstrate that the seller is absorbing certain risks during project development (if the PPA is for a facility not yet completed), as well as explicit performance and operational risks that utility customers might otherwise be required to absorb if the utility were to own the asset. Risks that may be avoided and thus provide benefits include, by way of example but not limitation, construction cost risk, O&M cost risk, unit availability risk, technology risk, or other performance or cost risks.
4) Only contracts 25 MW or greater with a delivery term of three years or longer are eligible for the incentive.[5]

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[1] It is NIPPC's intent that the utility would actually receive a 10% incentive, which may require for ratemaking purposes that the incentive would be "grossed up" so that, after taxes, a 10% incentive is actually achieved by the utility.
[2] *See* OAR 860-030-0010(6).
[3] *See* Order No. 94-590 (UM 551) at 14. Other benefits of PPAs include resource diversity (e.g., type and term) and flexibility for resource planning and acquisition.
[4] The utility would not receive an incentive on turnkey projects.
[5] The Commission's competitive bidding guidelines do not preclude the utilities from specifying contract sizes and terms less than 100 MW and five years. These are simply the minimum resources that the Commission expects the utilities to acquire under its guidelines.

5) Only PPAs contractually associated with specific assets by unit are eligible. Contracts may allow for economic displacement and include replacement power provisions.
6) Contracts that utilities must enter into by law, including mandatory contracts under the Public Utility Regulatory Policies Act with Qualifying Facilities, are *not* eligible.

Other Elements of the Proposal:

1) The utility should not consider the cost of the incentive in determining the RFP initial or final short-lists. To allow for consideration of risk mitigation benefits of PPAs, at a minimum the utility should include in the final short-list evaluation all PPAs whose price does not exceed 110 percent of the forward price curve. The Commission will consider the incentive in any acknowledgment proceeding for the final RFP short-list.
2) The Independent Evaluator should provide a formal recommendation on the eligibility of the PPA for which the utility requests the incentive based on the IE's assessment that the seller would be absorbing a significant amount of risk under the proposed contract.[6]
3) Any utility engaged in one or more PPAs under the incentive must report annually on its financial metrics and provide documentation demonstrating discernible effects on any imputed debt calculations and credit ratings.
4) The Commission should review the incentive within three years from the date the incentive is first included in rates. Further, the Commission should specify an incentive cap that would trigger a review of the mechanism prior to that time.

[6] The utility may also provide other information to the Commission that it deems relevant to the issue of risk absorption and the eligibility of a PPA for the incentive.

Attachment B

UM 1276
NIPPC Proposal: Addressing Utility Bias to Build
September 13, 2007

Summary: NIPPC proposes to directly address the bias for utility owned resources that is inherent in RFP evaluations in which a utility owned resource is an evaluation option by assuming that the IPP bid or bids have "won" an RFP if (i) the present value of delivered power from the IPP(s) bid is 110% or less of the present value of delivered power from a comparably evaluated utility owned resource, and (ii) the IPP bid(s) demonstrates risk absorption benefits to utility consumers.

Background & Support: This docket is part of a series of dockets opened by the Commission to examine its policies regarding new generating resources. In Order No. 05-133, the Commission expressed concern that rate basing utility owned resources would cause utilities to favor their own resources and directed this investigation to consider how the use of performance based ratemaking could offset utility bias in favor of owning resources. *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).

In Dockets UM 1056 (IRPs) and UM 1182 (RFPs), the Commission directed evaluation of the advantages and disadvantages of purchasing versus owning resources. In Order No. 07-002, the Commission directed that IRPs assess the relative merits of owning and purchasing resources. *In re Investigation into Integrated Resource Planning Requirements*, Order No. 07-002 (2007) at p. 22 (Guideline 13(a)). In Order No. 06-446, the Commission 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 re Investigation Regarding Competitive Bidding*, Order No. 06-446 (2006) at p. 12 (Guideline 10.d).

The Commission's orders demonstrate awareness that PPAs and utility owned resources bring different risks and benefits to consumers, but the Commission currently requires only general evaluative treatment of those risks and benefits in IRPs and RFPs. Particularly in RFP bid evaluations, the inability of utilities or independent evaluators to directly quantify the risk avoidance benefits that Power Purchase Agreements (PPAs) can provide creates an inherent bias in favor of utility owned resources.[1] The bias means that Oregon consumers will not be served

[1] The Independent Evaluator in the recent PacifiCorp RFP, the first conducted under UM 1182 Guidelines, stated that either 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, or alternatively, the utility's benchmark resource could be held to the same risk assignment standards as PPAs are held. *See,* The Oregon Independent Evaluator's Assessment of PacifiCorp's 2012 RFP Design, Part I, April 13, 2007, at pp. 22-23. The IE strongly preferred the second approach, but that method has been implicitly rejected by the Commission.

with an optimum mix of resources and, as a result, will assume greater risks than if utilities diversified their resources to included competitively-procured power delivered to them under long-term PPAs.

NIPPC proposes that the Commission mitigate this bias by applying a discount to PPA bids in RFP evaluations similar to the 10% discount applied to conservation resources when compared to supply side resources. The discount is a proxy value only.[2]

NIPPC Proposal:

1. Supplement Order No. 06-446 (UM 1182) with an Order in this docket that requires the explicit recognition in future RFP evaluations of risk avoidance attributes of PPAs that benefit consumers. Risk avoidance benefits are recognized in RFP evaluations by applying the conservation-type discount to IPP bids as follows.

2. In any RFP evaluation when there is a utility benchmark resource competing with IPP bids, presume that the present value of the cost of the IPP bid will not be treated as greater than the present value of the cost of the utility benchmark resource unless the cost of the IPP bid is greater than 110% of the cost of the utility benchmark, when the resources are consistently and comparably evaluated.

3. IPP bids are eligible for the favorable 10% proxy value discount only if the bid demonstrates that it will provide significant risk avoidance benefits to the utility and the utility's customers. Risks that may be avoided and thus provide benefits include, by way of example but not limitation, construction cost risk, O&M cost risk, unit availability risk, technology risk, or other performance or cost risks that utility customers might otherwise be required to absorb if the utility were to own the asset and that are explicitly identified by the Independent Evaluator at the time of RFP evaluation.

4. If an IPP bid(s) demonstrates risk avoidance attributes as required by item #3, and if the present value of the cost of the IPP bid(s) is not greater than 110% of the cost of the utility benchmark resource as provided in item #2, then there is a rebuttable presumption that the IPP bid(s) "won" the RFP. The Commission should rely on the counsel of the Independent Evaluator to establish whether an IPP bid demonstrates sufficient risk avoidance attributes to warrant application of the rebuttable presumption.

5. If the utility determines to select a utility benchmark resource under the circumstances of item #4, above, then the utility shall be required to demonstrate in an RFP acknowledgement and at the time of prudence review why the utility benchmark resource was selected.

[2] The 10% discount is a proxy value instead of an actual value. It will be difficult to actually quantify the risk avoidance benefits of purchases because such an analysis would be heavily dependent upon assumptions, and the assumptions would each be subject to challenge, making the attempt contentious without necessarily leading to better policy outcomes.

6. The NIPPC proposal is compatible with other specific incentive mechanisms that may be developed in this docket, such as the PacifiCorp CIM/pp approach to “rate basing” PPA expenditures, provided that the PPA chosen delivers risk avoidance value to consumers such as those described in item # 3, above.

Benefits of this Proposal: The 10% proxy value for IPP bid evaluation purposes provides value to Oregon consumers by directly addressing the inherent structural bias towards utility resources. The bias, if allowed to continue, will disadvantage consumers by decreasing the availability and variability of resources otherwise available to them. The proxy value thus contributes to the development of a competitive wholesale power sector and provides Oregon customers with broader and more cost-effective resource options.

Susan K. Ackerman, Attorney
9883 NW Nottage Dr.
Portland, Oregon, 972296

Telephone: (503) 297-2392
Facsimile: (503) 297-2398
Email: susan.k.ackerman@comcast.net

January 29, 2008

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 Reply Comments

Enclosed for filing are NIPPC Reply Comments (including Attachments A and B) in this docket. Hard copies 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 NIPPC Reply Comments 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 29st day of January, 2008.

/s/ Susan K. Ackerman
Susan K. Ackerman
Attorney for NIPPC
9883 NW Nottage Dr.
Portland, Oregon 97229

W	JOHN DEMOSS AGENT FOR PTW	70620 HWY 97 MORO OR 97039 turbineone@earthlink.net
	AF LEGAL & CONSULTING SERVICES	
	ANN L FISHER ATTORNEY AT LAW	PO BOX 25302 PORTLAND OR 97298-0302 energlaw@aol.com
W	**CITIZENS' UTILITY BOARD OF OREGON**	
	LOWREY R BROWN UTILITY ANALYST	610 SW BROADWAY - STE 308 PORTLAND OR 97205 lowrey@oregoncub.org
	JASON EISDORFER ENERGY PROGRAM DIRECTOR	610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
	ROBERT JENKS	610 SW BROADWAY STE 308 PORTLAND OR 97205 bob@oregoncub.org
W	**DAVISON VAN CLEVE PC**	
	MELINDA J DAVISON	333 SW TAYLOR - STE 400 PORTLAND OR 97204 mail@dvclaw.com
	DEPARTMENT OF JUSTICE	
	MICHAEL T WEIRICH ASSISTANT ATTORNEY GENERAL	REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 michael.weirich@doj.state.or.us
W	**ESLER STEPHENS & BUCKLEY**	

	JOHN W STEPHENS	888 SW FIFTH AVE STE 700 PORTLAND OR 97204-2021 stephens@eslerstephens.com
W	**IDAHO POWER COMPANY**	
	KARL BOKENKAMP GENERAL MANAGER-POWER SUPPLY PLANNING	PO BOX 70 BOISE ID 83707-0070 kbokenkamp@idahopower.com
	RIC GALE VP - REGULATORY AFFAIRS	PO BOX 70 BOISE ID 83707 rgale@idahopower.com
	SANDRA D HOLMES	PO BOX 70 BOISE ID 83707-0070 sholmes@idahopower.com
	BARTON L KLINE SENIOR ATTORNEY	PO BOX 70 BOISE ID 83707-0070 bkline@idahopower.com
	LISA D NORDSTROM ATTORNEY	PO BOX 70 BOISE ID 83707-0070 lnordstrom@idahopower.com
	GREGORY W SAID DIRECTOR - REVENUE REQUIREMENT	PO BOX 70 BOISE ID 83707 gsaid@idahopower.com
W	**MCDOWELL & RACKNER PC**	
	WENDY MCINDOO	520 SW 6TH AVE STE 830 PORTLAND OR 97204 wendy@mcd-law.com
	LISA F RACKNER ATTORNEY	520 SW SIXTH AVENUE STE 830 PORTLAND OR 97204 lisa@mcd-law.com
W	**NORTHWEST ENERGY COALITION**	
	STEVEN WEISS SR POLICY ASSOCIATE	4422 OREGON TRAIL CT NE SALEM OR 97305 steve@nwenergy.org
W	**NW INDEPENDENT POWER PRODUCERS**	
	ROBERT D KAHN EXECUTIVE DIRECTOR	7900 SE 28TH ST STE 200 MERCER ISLAND WA 98040 rkahn@nippc.org
W	**PACIFIC POWER & LIGHT**	
	MICHELLE R MISHOE LEGAL COUNSEL	825 NE MULTNOMAH STE 1800 PORTLAND OR 97232 michelle.mishoe@pacificorp.com
W	**PACIFICORP**	
	NATALIE HOCKEN VICE PRESIDENT & GENERAL	825 NE MULTNOMAH SUITE 2000

	COUNSEL	PORTLAND OR 97232 natalie.hocken@pacificorp.com
W	**PACIFICORP OREGON DOCKETS**	
	OREGON DOCKETS	825 NE MULTNOMAH ST STE 2000 PORTLAND OR 97232 oregondockets@pacificorp.com
	PORTLAND GENERAL ELECTRIC	
	PATRICK HAGER RATES & REGULATORY AFFAIRS	121 SW SALMON ST 1WTC0702 PORTLAND OR 97204 pge.opuc.filings@pgn.com
	PORTLAND GENERAL ELECTRIC COMPANY	
	J RICHARD GEORGE	121 SW SALMON ST 1WTC1301 PORTLAND OR 97204 richard.george@pgn.com
	PUBLIC UTILITY COMMISSION	
	JUDY JOHNSON	PO BOX 2148 SALEM OR 97308-2148 judy.johnson@state.or.us
W	**RENEWABLE NORTHWEST PROJECT**	
	ANN ENGLISH GRAVATT	917 SW OAK - STE 303 PORTLAND OR 97205 ann@rnp.org
W	**RFI CONSULTING INC**	
	RANDALL J FALKENBERG	PMB 362 8343 ROSWELL RD SANDY SPRINGS GA 30350 consultrfi@aol.com