
**PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1368

STAFF COMMENTS

Lisa Schwartz

REDACTED VERSION

August 13, 2008

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UM 1368**

In the Matter of PacifiCorp
Draft 2008R-1 Request for Proposals for
New Renewable Resources

STAFF'S REPLY COMMENTS

Pursuant to Judge Kirkpatrick's memorandum of July 17, 2008, staff submits reply comments on PacifiCorp's Draft Request for Proposals (RFP) for New Renewable Resources.

The company's Draft RFP was not accompanied by an assessment by the Oregon Independent Evaluator (IE) as directed in the Commission's competitive bidding guidelines. In opening comments, staff recommended numerous areas for the Oregon IE to address in the assessment. Staff filed the assessment on behalf of Boston Pacific Company on July 3, 2008. PacifiCorp filed a revised RFP on July 28, 2008, along with its reply to the IE's assessment.¹

Staff comments further at this time on five contentious issues in this proceeding:

- 1) The requirement in the pro forma power purchase agreement (PPA) that PacifiCorp has the right to purchase the bidder's facility at the end of the term or upon termination
- 2) The requirement that bidders (but not PacifiCorp) must demonstrate a contractual right to purchase wind turbines and other long lead-time equipment
- 3) The requirement that bidders take the federal production tax credit risk and include any related premium in bids
- 4) Rejection of bids with unfavorable Alternative Cost of Compliance (ACC) values
- 5) No accounting for capacity value in evaluation of bids and benchmark resources, including geographic diversity for wind resources

The schedule anticipates Commission consideration of the RFP at a public meeting. Staff will provide its recommendation regarding RFP approval in the staff report for the meeting, following review of parties' comments. Staff is still reviewing PacifiCorp's new ACC modeling method. Staff discussed this new modeling approach in opening

¹ On June 19, 2008, PacifiCorp filed its reply to opening comments from staff and Renewable Northwest Project (RNP).

comments in this proceeding and in Docket UE 200.² The IE raises concerns about the approach to the extent the company uses the results to justify taking less than the 500 MW target in the RFP. See IE's assessment, July 3, 2008, at 8-9. Staff agrees.

In the revised Draft RFP, the company has included a hybrid bidders fee/success fee structure with a specified maximum amount. However, the company set the maximum success fee at \$1 million. Staff finds this level to be unreasonably high and requests the IE and parties to comment on this.

Issue 1 – Facility purchase right at end of term

PacifiCorp originally proposed that bidders be required to sell their project for a dollar at the end of the project term.³ PacifiCorp agrees with the IE and RNP that bidders should be allowed to set the sales price. However, the company does not agree that bidders should have the option, not the requirement, to sell their facility to PacifiCorp.

Staff agrees with the stated concerns of the IE and RNP that developers whose business model does not include sale of sites or facilities will be precluded from bidding, significantly restricting competition. The IE also raises concerns that this requirement removes competition at the end of the contract term, because PacifiCorp will own most of the prime renewable resource sites. In addition, the IE is concerned that bid prices for PPAs will be unnecessarily high to compensate for the bidders' lost site value at the end of the term. See IE's assessment, July 3, 2008, at 15-16.

The company has not imposed such requirements on solicitations for thermal resources. See Docket Nos. UM 1208 and UM 1360. It is staff's understanding that the company plans to impose this requirement for renewable resources because of the importance of the wind regime at the site and ongoing renewable portfolio standard (RPS) requirements. PacifiCorp has argued elsewhere that overall cost, and not just the wind regime at a site, must be considered in determining whether to acquire a resource. See PPL/400, Tallman/10 in Docket UE 199.⁴ Staff agrees with the IE and RNP that requiring bidders to include the facility sale price in a PPA will push up bid prices for those willing to bid PPAs under this requirement, if any, and eliminate competition from others.

A requirement that PacifiCorp own the facility at the end of the PPA term also may preclude bidders from submitting bid options with shorter terms — say, 10 years. Staff is uncertain whether the Commission's interest in diversity of resource terms applies equally to renewable resources, where utilities are subject to ongoing acquisition obligations. However, technological changes that reduce certain project costs are among the issues the Commission should consider in ensuring shorter-term contracts

² Pursuant to OAR 860-014-0050(1)(e), staff asks the Commission and Administrative Law Judge to take official notice of its direct testimony in Docket UE 200 referenced herein.

³ Under such a scheme, a bidder would embed its facility sale price in power rates during the term.

⁴ Pursuant to OAR 860-014-0050(1)(e), staff asks the Commission and Administrative Law Judge to take official notice of PacifiCorp's rebuttal testimony in Docket UE 199 referenced herein.

are an option. For example, over time wind turbines grew larger and less costly to produce. Having some contracts with shorter terms avoids locking into technologies today that may become obsolete over a long contract (or ownership) term.

The IE finds it reasonable that build-own-transfer and Benchmark Resources be given some end-of-life benefit. However, the IE notes the difficulty in predicting the value of any asset at the end of the contract term – for example, 25 years from now.

Issue 2 – Contractual right to turbines

PacifiCorp does not agree with the IE or RNP that the company should have the same requirement as bidders to demonstrate a contractual right to purchase turbines or other long lead-time equipment. The company is concerned about recovering its costs if the Benchmark Resource is not selected in the RFP process.

The IE concludes that imposing this requirement on bidders, but not the company, does not meet the test of overall fairness of the solicitation process. If the company does not have a comparable requirement for Benchmark Resources, the IE plans to assess the extra risk that the self-build options impose on ratepayers. The IE also suggests the company could reduce its cost recovery risk for unused turbines by allowing bidders to offer site-only bids. See IE's assessment, July 3, 2008, at 10-11.

Staff does not find compelling PacifiCorp's argument that it is disadvantaged compared to bidders for reallocation of turbines to other projects. Further, to provide the most competition and access to all potential project sites, PacifiCorp should allow bidders to offer wind sites for the company to develop. If the company's Benchmark Resource is not selected in the RFP process, the turbines the company is obligated to purchase could be used at such sites. Alternatively, PacifiCorp could use the turbines for a Benchmark Resource in next year's RFP⁵ or resell them, likely at a profit. Staff also notes the company's profuse use of purchased turbines to develop wind projects under 100 MW without using any competitive process.

Issue 3 – Federal production tax credit risk

The federal production tax credit has not yet been renewed even for 2009, and projects with on-lines dates as late as year-end 2011 are eligible under the Draft RFP. For most renewable resources that qualify, the tax credit is worth \$20 per megawatt-hour for the first 10 years of project operation.⁶ The Draft RFP requires that bidders take the tax credit risk. The bidder may not change its price if the tax credit is not renewed.

PacifiCorp maintains that this requirement places the bidder in a symmetrical position with the company. Staff disagrees. PacifiCorp will not include a premium in its cost-based estimate for Benchmark Resource(s) related to tax credit risk, nor will build-own transfer bids include such a premium. Therefore, ownership options will appear far less

⁵ The company states that it plans to issue an RFP annually for renewable resources.

⁶ Open-loop biomass, small irrigation and landfill gas projects are eligible for a \$10/MWh tax credit.

expensive. Besides making fair comparisons among ownership and non-ownership options difficult, if not impossible, such an apparent advantage will stifle competition. If bidders decide to bid a PPA, they will include in the bid price a sizable premium for absorbing this risk.

Further, the production tax credit risk is far different for PacifiCorp than for bidders. Only the company has ongoing RPS obligations. Oregon ratepayers are required to pay the cost of prudently incurred renewable resources to meet the Oregon RPS, unless the cost exceeds four percent of annual revenue requirements. That is a large number. See, for example, Staff/202, Schwartz/8-12 in Docket UE 200.

If the tax credit is not extended, ratepayer costs for renewable resources will be significantly higher. Such a risk must be included in RFP evaluation.

The IE notes that PPA bidders must absorb the risk while build-own-transfer and Benchmark Resources may pass this risk to ratepayers. Therefore, the IE states, ownership options will have an advantage over PPA options. The IE sees the tax credit risk as similar to potential mandated controls for carbon emissions. The IE notes that in base load RFPs, the company has allowed bidders to pass through such costs to PacifiCorp. The IE is particularly concerned because the value of the tax credit is so large and bidders cannot predict or hedge this “political” risk. The IE provides examples of RFPs where bidders were allowed to: 1) submit bids with, and without, the tax credit or 2) make their bids contingent on tax credit extension. The IE recommends PPA bidders specify binding prices for futures with, and without, the tax credit. See IE’s assessment, July 3, 2008, at 13-14. Staff finds the IE’s solution simple, transparent and appropriate.

Issue 4 – Determining whether to acquire resources with a positive ACC value

In opening comments, staff stated that the Draft RFP does not explain how, in the event PacifiCorp cannot fulfill the 500 MW RFP target with bids that have a negative (favorable) ACC value, the company would determine whether to acquire any resources with a positive ACC value. Staff included the company’s response to the issue, stating it would consider RPS requirements, potential renewable energy credit sales or portfolio risk reduction.

Staff further stated that RFP evaluation using a single carbon emissions cost — PacifiCorp’s base-case assumption — is inconsistent with the company’s acknowledged 2007 Integrated Resource Plan (IRP) and the Commission’s competitive bidding guidelines.⁷ The IE included similar comments in its assessment of Draft RFP design. See IE’s assessment, July 3, 2008, at 8-9.

The company made no changes in the revised RFP to explain whether, or how, the company will acquire any resources with a positive ACC value. The company’s solution

⁷ The Commission updated its IRP environmental cost guideline in Order No. 08-339 (Docket UM 1302), issued June 30, 2008.

appears to be that it will issue another RFP next year, instead of acquiring any such resources. See PacifiCorp's July 28, 2008, comments at 3, lines 6-13. Staff cannot recommend RFP approval where the evaluation methodology is inconsistent with the company's acknowledged IRP and the Commission's competitive bidding guidelines and there is no compelling justification.

The ACC method compares the renewable resources (bids and Benchmark Resources) to the company's market-based (non-renewable) alternative. Higher carbon costs equate to higher electricity prices, potentially turning a positive ACC value (unfavorable compared to the market-based energy value of the bid) into a negative (favorable) ACC value. See staff's opening comments at 11-12.

In Docket UE 200, PacifiCorp's 2009 Renewable Adjustment Clause, [REDACTED]

[REDACTED] The company explains that a positive (unfavorable) ACC value can be compared to current or potential penalties for not complying with RPS requirements. See PPL/200, Tallman/9-10 and PPL/202.⁸

Staff does not understand why the company proposes to discard bids or Benchmark Resources with unfavorable ACC values without regard to RPS requirements, potential renewable energy credit sales and portfolio risk reduction benefits of renewable resources – including the risk that carbon costs will be higher than base-case values. Staff recommends the Commission require PacifiCorp to state in the RFP how the company will consider these items in determining whether to acquire resources with an unfavorable ACC value, if the company cannot acquire its targeted acquisition level (500 MW) with resources that have favorable ACC values. See staff's opening comments at 11 and PacifiCorp's response to Staff Data Request No. 17c, attached therein.

Issue 5 – Capacity value

The ACC method focuses on the market-based energy value of renewable resources. Staff, RNP and the IE recommend the company also account for capacity value, including the value of geographic diversity in the evaluation of bids and Benchmark Resources. Wind resources have unique wind profiles that vary by location and have greater or lesser value depending on how they interact with other wind resources integrated in the utility's portfolio.

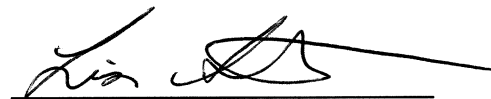
The IE is concerned about appropriately accounting for all of the values of various resource types. To the extent the company does not achieve its 500 MW target for the RFP and does not acquire any renewable resources with unfavorable ACC values, the need to value their capacity is further highlighted.

⁸ Pursuant to OAR 860-014-0050(1)(e), staff asks the Commission and Administrative Law Judge to take official notice of PacifiCorp's direct testimony in Docket UE 200 referenced herein.

The company maintains that capacity value should only be addressed in the IRP process, and there is no need to address the issue in RFPs. However, the Commission requires that RFP modeling methods be aligned with those used in the company's most recently acknowledged IRP. Costs, benefits and risks assessed in the IRP process should similarly be assessed in the RFP process.

The IE has provided suggestions directly to the company on how to capture capacity value. The IE should include its recommendations on this issue in its forthcoming comments on PacifiCorp's revised draft RFP.

Dated at Salem, Oregon, this 13th day of August 2008



Lisa Schwartz
Senior Analyst
Electric and Natural Gas Division

CERTIFICATE OF SERVICE

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I certify that I have this day served the foregoing document upon all parties of record in this proceeding 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 the following parties or attorneys of parties.

Dated at Salem, Oregon, this 13th day of August, 2008.

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