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May 9, 2023

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
Filing Center
P.O. Box 1088
201 High Street SE, Suite 100
Salem, Oregon 97308-1088

Re: UM 2255 - In the Matter of Idaho Power Company, Application for Approval of 2026 All-Source Request for Proposals to Meet 2026 Capacity Resource Need.

Attention Filing Center:

Attached for filing in the above-captioned docket are Idaho Power Company's Reply Comments on Staff's Report.

Please contact this office with any questions.

Sincerely,

Suzanne Prinsen
Legal Assistant

Attachments

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 2255

In the Matter of

IDAHO POWER COMPANY,

Application for Approval of 2026 All-
Source Request for Proposals to Meet
2026 Capacity Resource Need.

**IDAHO POWER COMPANY'S
REPLY COMMENTS ON STAFF'S
REPORT**

1

I. INTRODUCTION

2

In accordance with the schedule filed by Staff on April 19, 2023, Idaho Power Company ("Idaho Power" or "Company") hereby submits these comments responding to the Staff Report filed on May 2, 2023, recommending approval, with conditions, of the Company's draft 2026 All-Source Request for Proposals ("2026 AS RFP") and Scoring and Modeling Methodology ("SMM"). Idaho Power appreciates Staff's review of the 2026 AS RFP and the opportunity to submit these comments responding to Staff's recommended conditions.

8

The Company largely accepts Staff's recommendations and will incorporate the specific conditions into the 2026 AS RFP documents. The Company does not, however, accept Staff's recommendation to exclude the impacts of imputed debt costs associated with long-term power purchase agreements ("PPA") and battery storage agreements ("BSA"). The Company therefore requests that the Public Utility Commission of Oregon ("Commission") approve the 2026 AS RFP, as revised below, including allowing the Company to consider the full range of costs associated with PPAs and BSAs, including imputed debt. In the alternative to accounting for imputed debt in the SMM, the Company requests that the Commission leave open the option for the Company to consider imputed debt when selecting the final bids from the initial shortlist of bids, as further explained below.

17

1 **II. DISCUSSION**

2 The following section addresses each of Staff’s recommended conditions and provides
3 Idaho Power’s response.

4 **A. SMM Condition 1: Idaho Power provides the specific weighting for each**
5 **question included in the Project Readiness and Deliverability section of its**
6 **Non-Price Scoring Matrix.**

7 Idaho Power agrees to this condition and updated the draft 2026 AS RFP and Exhibit D
8 – Non-Price Scoring Matrix.

9 **B. SMM Condition 2: Idaho Power amends its Non-Price Scoring Matrix to**
10 **remove any scoring penalties applied to bidders that provide redlines to**
11 **form contracts or other elements of the RFP and its exhibits.**

12 Idaho Power agrees to this condition and updated the draft 2026 AS RFP and Exhibit D
13 – Non-Price Scoring Matrix. The Company’s proposed scoring matrix included five questions in
14 the Contracting Progress and Viability section. In response to Staff’s recommendation, the
15 Company has incorporated these five questions into a single question that allows the bidder to
16 answer “Yes” or “No”:

17 **Commercial Assessment (100%) Bidder represents that bidder**
18 **has reviewed the Draft Form Agreements, Technical**
19 **Specifications, and Draft Form Letter of Credit and that bidder's**
20 **firm bid takes into account the terms of these documents or the**
21 **terms of these documents as red-lined and submitted with bidder's**
22 **firm bid (ie – product, price, term, performance guarantees, delay**
23 **damages, milestone payments, etc.).**

24 An answer of “Yes” will be awarded five points and an answer of “No” will be awarded
25 zero points. Idaho Power agrees that the Contracting Progress and Viability section contributes
26 a relatively low total weighting to the non-price score and agrees the revision is consistent with
27 the original intent, which was to ensure Bidders review the Draft Form Agreements.
28 Furthermore, Idaho Power also understands that contracts are negotiable and the final executed
29 form of contract may differ from the forms included with the RFP.

1 **C. SMM Condition 3: Idaho Power does not add or apply any cost of imputed**
2 **debt to the price scores of any bids, specifically those using PPAs, BSAs,**
3 **or similar contractual structures.**

4 Idaho Power discussed the Company’s position on imputed debt in its Reply Comments
5 filed on March 24, 2023,¹ and this position has not changed. As explained in those comments,
6 the Company takes proactive steps to manage and mitigate financial risk and costs to
7 customers. It is in the interest of customers to preserve Idaho Power’s credit profile and
8 maintain a solid balance sheet to support existing and planned infrastructure. Maintaining a
9 positive credit profile keeps interest expense low and ultimately keeps costs low for Idaho
10 Power customers. Were Idaho Power to ignore the effect of imputed debt from long-term
11 contractual obligations in its analysis of RFP responses from third parties, it would not be
12 evaluating the projects on a financially comparable basis, nor would it be correctly assessing the
13 net financial impact of the project on its customers.

14 Entering into a long-term agreement for energy or capacity results in a debt-like payment
15 obligation that is either imputed by the rating agencies or an actual debt on the Company’s
16 balance sheet. For PPAs or BSAs containing dispatch rights, Idaho Power is required to record
17 a liability on its balance sheet under Generally Accepted Accounting Principles (GAAP). For
18 PPAs that do not have dispatch rights, when determining credit ratings, major rating agencies
19 such as Moody’s and S&P recognize the debt-like financial obligation of these contracts and
20 increase debt on a company’s balance sheet to assess the financial risk of the Company. For a
21 discussion of this concept by one of these agencies, please see the attached document from
22 Standard & Poor’s that summarizes the concept of imputed debt on PPA’s and how it is applied
23 when analyzing credit ratings.

¹ See pages 6-15.

1 To illustrate S&P's methodology of imputing debt for Idaho Power related to its PPAs,
2 the Company is providing the following simplified example. At a high level, this example
3 determines imputed debt by calculating the present value of the stream of payments associated
4 with the contract and multiplying it by an assumed risk factor. As discussed on pages 3 and 4 of
5 the attached report, S&P applies a risk factor in accordance with "the strength and availability of
6 regulatory or legislative vehicles for the recovery of the capacity costs associated with power
7 supply arrangements." Therefore, this simplified example provides a hypothetical 10-year PPA
8 with payments of \$1 million per year, an assumed debt cost of 5.50% (based on Idaho Power's
9 current cost of debt), and a risk factor of 50% (the midpoint of the range discussed in
10 Attachment 1).

11

12 *Example of Imputed Debt Calculation*

13 *10 years x \$1,000,000 annual payments = \$10,000,000 payment obligation*

14 *Net Present Value at 5.50% discount rate = \$7,537,625*

15 *\$7,537,625 x 50% risk factor = \$3,768,813 imputed debt*

16

17 Applying this methodology to Idaho Power's current PPA obligations results in approximately
18 \$1.2 billion of additional debt on its balance sheet.

19 The addition of debt to a company's balance sheet results in higher financial risk, lower
20 credit ratings, and in the long-run higher interest rates. Like most corporations, a regulated
21 investor-owned utility rarely if ever retires debt; rather, the Company refinances it. Therefore,
22 higher interest rates because of imputed debt will apply not just to the next bond offering but
23 eventually to all of Idaho Power's \$2.5 billion of debt.

24 The impact of imputed debt can be addressed in two ways. One option would be for a
25 utility to take no action, which would degrade its financial position in the eyes of ratings

1 agencies as the accumulation of imputed debt would ultimately result in a more highly-leveraged
2 capital structure. The degradation of a utility's credit rating ultimately results in higher costs over
3 the long-run, as a drop below investment grade ratings levels would trigger significantly higher
4 interest rates, reduced ability to access debt and equity markets, and other financial impacts
5 such as posting additional collateral to support credit-contingent power supply contract
6 requirements. Another option is to neutralize the impact of higher imputed debt by issuing
7 additional equity to move the Company's debt-to-equity ratio back in line with pre-imputed debt
8 additions applied by the rating agencies. As envisioned, the Company's proposed SMM would
9 account for the cost of readjusting the Company's debt-to-equity ratio for each PPA or BSA.²

10 Staff expressed four primary concerns with the use of imputed debt. First, Staff is
11 concerned that imputing debt for PPAs and BSAs would put third-party bids using those
12 structures at a marked disadvantage to utility-owned resources. However, if imputed debt is not
13 incorporated, Idaho Power believes the SMM would be ignoring costs associated with these
14 contract structures. The imputed debt cost calculation is intended to capture the full total cost of
15 a PPA or BSA to Idaho Power's customers. The purpose of the RFP is to provide Idaho Power
16 customers with the lowest cost and least risk projects to reliably serve load. Excluding portions
17 of real costs to customers such as imputed debt from the evaluation process will ignore real
18 future costs to Idaho Power customers.

19 Second, Staff is concerned that stakeholders and potential bidders are unable to
20 independently verify the imputed debt costs the Company seeks to impose on bidders and there
21 are too many unknown variables for Staff to assess the imputed debt adder the Company is
22 seeking to impose. Notably, Staff does not appear to question the fact that imputed debt
23 resulting from PPAs and BSAs will impose actual costs on customers. Rather, the question is

² See pages 13 to 14 of the Company's our March 24, 2023, Reply Comments for additional detail on the methodology.

1 how to measure that cost. The Company provided its proposed methodology to Staff and
2 stakeholders for their review through discovery in this case, and further exemplified the
3 methodology above. The calculations are transparent, repeatable and can be applied
4 consistently for all RFP bidders. Additionally, the Company is open to retaining a third-party
5 expert to provide an independent assessment of the methodology, to the extent that would
6 resolve Staff's concerns.

7 Third, Staff is concerned that without a comprehensive picture of the Company's balance
8 sheet and credit position, it is not possible for Staff to evaluate whether the imputed debt adder
9 proposed by the Company fairly and accurately reflects the increased debt costs attributable to
10 any individual PPA or BSA. According to Staff, evaluating the accuracy of the debt attribution
11 would require information and a level of analysis that are outside of what is feasible within the
12 context of this procurement. As shown above, the Company's calculation of imputed debt
13 follows the process that rating agencies use and the methodology used to impute debt is not
14 dependent on the Company's balance sheet. The calculation for the imputed debt is
15 straightforward and can be calculated without a comprehensive picture of the Company's
16 balance sheet.

17 Fourth, Staff believes that any issues related to the Company's credit profile and credit
18 risks be addressed in a rate proceeding, consistent with prior Commission precedent. While the
19 Company agrees that the impact of a higher overall cost of capital would need to be addressed
20 in a future rate case, the evaluation of the costs to customers of different bid structures must be
21 included in the RFP to assure the selection of bids—and the costs that will be included in future
22 customer rates—is reasonable and based on the totality of the costs of each resource option.

23 In summary, for the reasons stated above, Idaho Power believes imputed debt should be
24 included in the SMM in this docket. In the alternative, if the Commission rejects inclusion of
25 imputed debt in the SMM, the Company requests authorization to consider the cost of imputed

1 debt when selecting final bids from the initial shortlist. This approach is consistent with the
2 Commission’s prior Competitive Bidding Guidelines³ and would ensure that the Company’s
3 evaluation of bids is comprehensive and reasonably accounts for all the costs and risks
4 associated with PPAs and BSAs.

5
6 **D. RFP Condition 1: Idaho Power provides a table clearly delineating any and**
7 **all modeling inputs and assumptions that will be used in this procurement,**
8 **showing how those values differ from the values provided in its 2021 IRP**
9 **and providing support for all changes.**

10 Idaho Power agrees to this condition and updated the draft 2026 AS RFP by adding
11 Exhibit Q – IRP Modeling Assumptions.

12 **E. RFP Condition 2: Idaho Power clarifies that no bids will be excluded or**
13 **otherwise penalized as long as all materials and documentation have been**
14 **completed and submitted by the Bid Due Date, scheduled for June 13,**
15 **2023, in the Final RFP.**

16 Idaho Power agrees to this condition and updated the draft 2026 AS RFP schedule.
17 Additionally, Idaho Power shared this clarification with all potential bidders on May 4, 2023,
18 through published Questions and Answers.

19 **F. RFP Condition 3: Idaho Power removes from the Final RFP the**
20 **Supplemental Fee to bidders selected for the Final Shortlist.**

21 Idaho Power agrees to this condition and updated the draft 2026 AS RFP.

22 **G. RFP Condition 4: Idaho Power updates item No. 6⁴ on the BEC by adding**
23 **the following language, “Documentation can include construction plans**
24 **and schedules, evidence that necessary permits have been or are being**
25 **acquired, proof of equipment procurement and delivery on site, and**

³ See Order No. 14-149.

⁴ The Staff Report discusses item No. 6 in the BEC and applies its condition to item No. 6. The Company therefore believes that the report’s reference to item No. 2 is an error.

1 **interconnection studies and agreements that support the commercial**
2 **operation date.”**

3 Idaho Power agrees to this condition and updated the draft 2026 AS RFP and Exhibit C
4 – Bid Eligibility Checklist. The following will be incorporated to Exhibit C – Bid Eligibility
5 Checklist as item No. 6:

6 Documentation may include, as applicable, GIA status and timely
7 interconnection capability; federal, state, and local permitting
8 requirements and decisions; land-use and site control
9 requirements and decisions; construction plans and schedules;
10 procurement documentation; financing capability and sources; and
11 other relevant documentation necessary to demonstrate timely
12 viability of the project. Idaho Power will also consider (and bidder
13 must identify) pending, actual, or threatened administrative, legal,
14 legislative, procedural, and other actions (federal, state, or local)
15 that could impact timely viability.

16 **H. RFP Condition 5: Idaho Power changes the transmission requirements in**
17 **Exhibit C of the Final RFP to make them consistent with Exhibit D.**

18 Idaho Power agrees to this condition and updated the draft RFP and Exhibit C – Bid
19 Eligibility Checklist.

20 The following will be incorporated into Exhibit C – Bid Eligibility Checklist as item No. 2:

21 **Resource Based Product** - Product will be delivered to a Point of
22 Delivery on IPC's transmission system OR if the product will be
23 interconnected to a third-party transmission system, Bidder has
24 provided documentation that demonstrates it has submitted
25 applicable transmission service requests to the relevant
26 Transmission Provider to establish transmission rights to deliver to
27 IPC point of delivery.

28 **I. RFP Condition 6: Idaho Power increases the cure period in the Final RFP**
29 **for mistakes in the Bid Entry or other forms to five calendar days from the**
30 **date the bidder is notified of the deficiency by IPC.**

31 Idaho Power agrees to this condition and updated the draft RFP.

32 **J. RFP Condition 7: Idaho Power removes §8.5 “Negotiation of Facility**
33 **Purchase” from all Draft Form Agreements in which it appears.**

34 The proposed Draft Form Agreement included a proposed provision that was intended to
35 provide the Company with something akin to a right of first refusal if the counterparty intended to

1 sell the facility. Idaho Power acknowledges Staff's concern with how the provision was drafted,
2 which appeared to effectively turn every potential bid into a utility-owned resource. The
3 Company has therefore proposed modifications, set forth below, that do not require that "Parties
4 agree to commence negotiations," which was not the intent of the provision.

5 In addition, Idaho Power acknowledges that the contracts are highly negotiable and that
6 the executed contract agreed to by a Bidder may differ from the Draft Form Agreement included
7 with the RFP. Indeed, Bidders have the opportunity to redline this provision when they submit
8 their bid and, pursuant to SMM Condition 2, Bidders will not be penalized for providing redlines
9 to the Draft Form Agreements. With that in mind, Idaho Power has modified the draft RFP and
10 Exhibit H – Draft Form Agreements with brackets around negotiable items such as credit
11 support amounts and project insurance requirements, including the following:

12 Negotiation of Facility Purchase. Promptly following the Effective
13 Date, the Parties agree to ~~commence negotiation~~ discuss in good
14 faith potential options for Buyer's purchase of the Facility (or,
15 alternatively, all or a portion of the equity interests of the entity or
16 entities owning the Facility, including potential limited partnership
17 interests or limited liability company membership interests), under
18 terms and conditions and pursuant to a purchase and sale
19 agreement that are commercially reasonable for a facility of the
20 nature and size of the Facility and at a price mutually agreed upon
21 by the Parties, taking into account the income tax credits
22 associated with the Facility. The Parties will have a maximum of
23 one hundred and twenty (120) days following the Effective Date
24 (failing the completion of which by such date, this sentence
25 Section shall expire by its terms) to negotiate such purchase
26 under a timeline that provides for Buyer's acquisition of such
27 Facility or equity interests no later than immediately prior to the
28 Commercial Operation Date of the Facility, unless the Parties
29 mutually agree to a purchase, or a deadline for negotiation, for an
30 earlier or later date. Buyer shall not be obligated to purchase the
31 Facility or equity interests unless it shall have reached mutual
32 agreement with the Seller on the purchase price for the Facility or
33 equity interests.

34 **K. Idaho Power's 2028 Resource Need**

35 Idaho Power is currently preparing its 2023 Integrated Resource Plan ("IRP"). The
36 Company's analysis indicates that there will be an additional resource need in 2028, even after

1 resources are procured in accordance with this 2026 AS RFP, which is seeking resources able
2 to provide energy and capacity in 2026 and 2027. To increase efficiency and enable resources
3 with longer lead times to bid into this 2026 AS RFP, the Company would like to modestly
4 expand its scope to include resources able to reach commercial operation in 2028. This
5 approach would allow the Company to expand its bid pool to potentially include resources
6 beyond wind, solar, and storage, thus improving resource diversity, and would be a much more
7 efficient way to address the looming 2028 resource need. Expanding the RFP to include 2028
8 resources would require minimal changes to the RFP documents and would be a
9 straightforward and efficient way to meet all the Company's resource needs through a single
10 procurement. The Company believes issuing an addendum to the current 2026 AS RFP with a
11 defined schedule, specific to potential 2028 resources, is an efficient mechanism to allow 2028
12 resource bids while not compromising the current 2026 AS RFP schedule.

13 However, maintaining the current RFP schedule is critical to meeting the Company's
14 near-term need. Therefore, if expanding the scope of the RFP to include 2028 resources would
15 require any delay to the already compressed timeline, then the Company will not do so and
16 instead issue a second RFP for the 2028 need.

17 **L. 2026 AS RFP Schedule Revision**

18 Idaho Power updated Table 2.1 – Key Milestones for the Solicitation to clarify that the
19 Company will file with the Commission and the Independent Evaluator the Benchmark Bid
20 evaluation and await the Independent Evaluator's reply comments ahead of opening the AS
21 RFP Bids.

22 **III. CONCLUSION**

23 Idaho Power appreciates Staff's review of the 2026 AS RFP and Staff's recommended
24 conditions. The Company has largely accepted Staff's recommendations, with the exception of
25 the proposal to ignore imputed debt cost. Imputed debt is a real cost that will impact customers

1 and must be reasonably considered in order to determine whether a bid is the least-cost, least-
2 risk resource to meet the Company's need. The costs of bids resulting in Idaho Power
3 ownership appropriately reflect the capital costs of those resources and non-utility owned bids
4 should do so too. Ignoring imputed debt tips the scales in favor of non-utility bids at the expense
5 of customers. Therefore, the Company requests that the Commission approved the 2026 AS
6 RFP, as modified above, so that the Company can expeditiously move forward with the
7 procurement. If, however, the Commission is disinclined to allow the SMM to expressly
8 consider imputed debt, the Company requests approval to consider imputed debt when
9 selecting the final bids from the initial shortlist of bids.

Respectfully submitted this 9th day of May 2023.

MCDOWELL RACKNER GIBSON PC



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IDAHO POWER COMPANY

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Docket UM 2255

Attachment 1

to

**Idaho Power Company's
Reply Comments on Staff Report**

*Standard & Poor's Methodology for Imputing Debt
for U.S. Utilities' Power Purchase Agreements
2007*

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May 7, 2007

Criteria | Corporates | Utilities:
**Standard & Poor's Methodology For
Imputing Debt For U.S. Utilities'
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Criteria | Corporates | Utilities:

Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

For many years, Standard & Poor's Ratings Services has viewed power supply agreements (PPA) in the U.S. utility sector as creating fixed, debt-like, financial obligations that represent substitutes for debt-financed capital investments in generation capacity. In a sense, a utility that has entered into a PPA has contracted with a supplier to make the financial investment on its behalf. Consequently, PPA fixed obligations, in the form of capacity payments, merit inclusion in a utility's financial metrics as though they are part of a utility's permanent capital structure and are incorporated in our assessment of a utility's creditworthiness.

We adjust utilities' financial metrics, incorporating PPA fixed obligations, so that we can compare companies that finance and build generation capacity and those that purchase capacity to satisfy customer needs. The analytical goal of our financial adjustments for PPAs is to reflect fixed obligations in a way that depicts the credit exposure that is added by PPAs. That said, PPAs also benefit utilities that enter into contracts with suppliers because PPAs will typically shift various risks to the suppliers, such as construction risk and most of the operating risk. PPAs can also provide utilities with asset diversity that might not have been achievable through self-build. The principal risk borne by a utility that relies on PPAs is the recovery of the financial obligation in rates.

The Mechanics Of PPA Debt Imputation

A starting point for calculating the debt to be imputed for PPA-related fixed obligations can be found among the "commitments and contingencies" in the notes to a utility's financial statements. We calculate a net present value (NPV) of the stream of the outstanding contracts' capacity payments reported in the financial statements as the foundation of our financial adjustments.

The notes to the financial statements enumerate capacity payments for the five years succeeding the annual report and a "thereafter" period. While we have access to proprietary forecasts that show the detail underlying the costs that are amalgamated beyond the five-year horizon, others, for purposes of calculating an NPV, can divide the amount reported as "thereafter" by the average of the capacity payments in the preceding five years to derive an approximate tenor of the amounts combined as the sum of the obligations beyond the fifth year.

In calculating debt equivalents, we also include new contracts that will commence during the forecast period. Such contracts aren't reflected in the notes to the financial statements, but relevant information regarding these contracts are provided to us on a confidential basis. If a contract has been executed but the energy will not flow until some later period, we won't impute debt for that contract until the year that energy deliveries begin under the contract if the contract represents incremental capacity. However, to the extent that the contract will simply replace an expiring contract, we will impute debt as though the future contract is a continuation of the existing contract.

We calculate the NPV of capacity payments using a discount rate equivalent to the company's average cost of debt, net of securitization debt. Once we arrive at the NPV, we apply a risk factor, as is discussed below, to reflect the benefits of regulatory or legislative cost recovery mechanisms.

Criteria Corporates Utilities: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

Balance sheet debt is increased by the risk-factor-adjusted NPV of the stream of capacity payments. We derive an adjusted debt-to-capitalization ratio by adding the adjusted NPV to both the numerator and the denominator of that ratio.

We calculate an implied interest expense for the imputed debt by multiplying the same utility average cost of debt used as the discount rate in the NPV calculation by the amount of imputed debt. The adjusted FFO-to-interest expense ratio is calculated by adding the implied interest expense to both the numerator and denominator of the equation. We also add implied depreciation to the equation's numerator. We calculate the adjusted FFO-to-total-debt ratio by adding imputed debt to the equation's denominator and an implied depreciation expense to its numerator.

Our adjusted cash flow credit metrics include a depreciation expense adjustment to FFO. This adjustment represents a vehicle for capturing the ownership-like attributes of the contracted asset and tempers the effects of imputation on the cash flow ratios. We derive the depreciation expense adjustment by multiplying the relevant year's capacity payment obligation by the risk factor and then subtracting the implied PPA-related interest expense for that year from the product of the risk factor times the scheduled capacity payment.

Risk Factors

The NPVs that Standard & Poor's calculates to adjust reported financial metrics to capture PPA capacity payments are multiplied by risk factors. These risk factors typically range between 0% to 50%, but can be as high as 100%. Risk factors are inversely related to the strength and availability of regulatory or legislative vehicles for the recovery of the capacity costs associated with power supply arrangements. The strongest recovery mechanisms translate into the smallest risk factors. A 100% risk factor would signify that all risk related to contractual obligations rests on the company with no mitigating regulatory or legislative support.

For example, an unregulated energy company that has entered into a tolling arrangement with a third-party supplier would be assigned a 100% risk factor. Conversely, a 0% risk factor indicates that the burden of the contractual payments rests solely with ratepayers. This type of arrangement is frequently found among regulated utilities that act as conduits for the delivery of a third party's electricity and essentially deliver power, collect charges, and remit revenues to the suppliers. These utilities have typically been directed to sell all their generation assets, are barred from developing new generation assets, and the power supplied to their customers is sourced through a state auction or third parties, leaving the utilities to act as intermediaries between retail customers and the electricity suppliers.

Intermediate degrees of recovery risk are presented by a number of regulatory and legislative mechanisms. For example, some regulators use a utility's rate case to establish base rates that provide for the recovery of the fixed costs created by PPAs. Although we see this type of mechanism as generally supportive of credit quality, the fact remains that the utility will need to litigate the right to recover costs and the prudence of PPA capacity payments in successive rate cases to ensure ongoing recovery of its fixed costs. For such a PPA, we employ a 50% risk factor. In cases where a regulator has established a power cost adjustment mechanism that recovers all prudent PPA costs, we employ a risk factor of 25% because the recovery hurdle is lower than it is for a utility that must litigate time and again its right to recover costs.

We recognize that there are certain jurisdictions that have true-up mechanisms that are more favorable and frequent than the review of base rates, but still don't amount to pure pass-through mechanisms. Some of these mechanisms

Criteria Corporates Utilities: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

are triggered when certain financial thresholds are met or after prescribed periods of time have passed. In these instances, in calculating adjusted ratios, we will employ a risk factor between the revised 25% risk factors for utilities with power cost adjustment mechanisms and 50%.

Finally, we view legislatively created cost recovery mechanisms as longer lasting and more resilient to change than regulatory cost recovery vehicles. Consequently, such mechanisms lead to risk factors between 0% and 15%, depending on the legislative provisions for cost recovery and the supply function borne by the utility. Legislative guarantees of complete and timely recovery of costs are particularly important to achieving the lowest risk factors.

Illustration Of The PPA Adjustment Methodology

The calculations of the debt equivalents, implied interest expense, depreciation expense, and adjusted financial metrics, using risk factors, are illustrated in the following example:

Example Of Power-Purchase Agreement Adjustment							
(\$000s)	Assumption	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter
Cash from operations	2,000,000						
Funds from operations	1,500,000						
Interest expense	444,000						
Directly issued debt							
Short-term debt	600,000						
Long-term due within one year	300,000						
Long-term debt	6,500,000						
Shareholder's Equity	6,000,000						
Fixed capacity commitments	600,000	600,000	600,000	600,000	600,000	600,000	4,200,000*
NPV of fixed capacity commitments							
Using a 6.0% discount rate	5,030,306						
Application of an assumed 25% risk factor	1,257,577						
Implied interest expense [¶]	75,455						
Implied depreciation expense	74,545						
Unadjusted ratios							
FFO to interest (x)	4.4						
FFO to total Debt (%)	20.0						
Debt to capitalization (%)	55.0						
Ratios adjusted for debt imputation							
FFO to interest (x) [§]	4.0						
FFO to total debt (%)**	18.0						
Debt to capitalization (%) ^{¶¶}	59.0						

*Thereafter approximate years: 7. [¶]The current year's implied interest is subtracted from the product of the risk factor multiplied by the current year's capacity payment. [§]Adds implied interest to the numerator and denominator and adds implied depreciation to FFO. ^{**}Adds implied depreciation expense to FFO and implied debt to reported debt. ^{¶¶}Adds implied debt to both the numerator and the denominator. FFO--Funds from operations. NPV--Net present value.

Criteria Corporates Utilities: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

Short-Term Contracts

Standard & Poor's has abandoned its historical practice of not imputing debt for contracts with terms of three years or less. However, we understand that there are some utilities that use short-term PPAs of approximately one year or less as gap fillers pending the construction of new capacity. To the extent that such short-term supply arrangements represent a nominal percentage of demand and serve the purposes described above, we will neither impute debt for such contracts nor provide evergreen treatment to such contracts.

Evergreen Treatment

The NPV of the fixed obligations associated with a portfolio of short-term or intermediate-term contracts can lead to distortions in a utility's financial profile relative to the NPV of the fixed obligations of a utility with a portfolio of PPAs that is made up of longer-term commitments. Where there is the potential for such distortions, rating committees will consider evergreen treatment of existing PPA obligations as a scenario for inclusion in the rating analysis. Evergreen treatment extends the tenor of short- and intermediate-term contracts to reflect the long-term obligation of electric utilities to meet their customers' demand for electricity.

While we have concluded that there is a limited pool of utilities whose portfolios of existing and projected PPAs don't meaningfully correspond to long-term load serving obligations, we will nevertheless apply evergreen treatment in those cases where the portfolio of existing and projected PPAs is inconsistent with long-term load-serving obligations. A blanket application of evergreen treatment is not warranted.

To provide evergreen treatment, Standard & Poor's starts by looking at the tenor of outstanding PPAs. Others can look to the "commitments and contingencies" in the notes to a utility's financial statements to derive an approximate tenor of the contracts. If we conclude that the duration of PPAs is short relative to our targeted tenor, we would then add capacity payments until the targeted tenor is achieved. Based on our analysis of several companies, we have determined that the evergreen extension of the tenor of existing contracts and anticipated contracts should extend contracts to a common length of about 12 years.

The price for the capacity that we add will be derived from new peaker entry economics. We use empirical data to establish the cost of developing new peaking capacity and reflect regional differences in our analysis. The cost of new capacity is translated into a dollars per kilowatt-year (kW-year) figure using a weighted average cost of capital for the utility and a proxy capital recovery period.

Analytical Treatment Of Contracts With All-In Energy Prices

The pricing for some PPA contracts is stated as a single, all-in energy price. Standard & Poor's considers an implied capacity price that funds the recovery of the supplier's capital investment to be subsumed within the all-in energy price. Consequently, we use a proxy capacity charge, stated in \$/kW, to calculate an implied capacity payment associated with the PPA. The \$/kW figure is multiplied by the number of kilowatts under contract. In cases of resources such as wind power that exhibit very low capacity factors, we will adjust the kilowatts under contract to reflect the anticipated capacity factor that the resource is expected to achieve.

We derive the proxy cost of capacity using empirical data evidencing the cost of developing new peaking capacity.

Criteria Corporates Utilities: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

We will reflect regional differences in our analysis. The cost of new capacity is translated into a \$/kW figure using a weighted average cost of capital and a proxy capital recovery period. This number will be updated from time to time to reflect prevailing costs for the development and financing of the marginal unit, a combustion turbine.

Transmission Arrangements

In recent years, some utilities have entered into long-term transmission contracts in lieu of building generation. In some cases, these contracts provide access to specific power plants, while other transmission arrangements provide access to competitive wholesale electricity markets. We have concluded that these types of transmission arrangements represent extensions of the power plants to which they are connected or the markets that they serve. Irrespective of whether these transmission lines are integral to the delivery of power from a specific plant or are conduits to wholesale markets, we view these arrangements as exhibiting very strong parallels to PPAs as a substitute for investment in power plants. Consequently, we will impute debt for the fixed costs associated with long-term transmission contracts.

PPAs Treated As Leases

Several utilities have reported that their accountants dictate that certain PPAs need to be treated as leases for accounting purposes due to the tenor of the PPA or the residual value of the asset upon the PPA's expiration. We have consistently taken the position that companies should identify those capacity charges that are subject to operating lease treatment in the financial statements so that we can accord PPA treatment to those obligations, in lieu of lease treatment. That is, PPAs that receive operating lease treatment for accounting purposes won't be subject to a 100% risk factor for analytical purposes as though they were leases. Rather, the NPV of the stream of capacity payments associated with these PPAs will be reduced by the risk factor that is applied to the utility's other PPA commitments. PPAs that are treated as capital leases for accounting purposes will not receive PPA treatment because capital lease treatment indicates that the plant under contract economically "belongs" to the utility.

Evaluating The Effect Of PPAs

Though history is on the side of full cost recovery, PPAs nevertheless add financial obligations that heighten financial risk. Yet, we apply risk factors that reduce debt imputation to recognize that utilities that rely on PPAs transfer significant risks to ratepayers and suppliers.

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