

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1182
(Phase II)

In the Matter of

PUBLIC UTILITY COMMISSION OF
OREGON

ORDER

Investigation Regarding Competitive Bidding.

DISPOSITION: ALJ RULING AFFIRMED WITH MODIFICATION TO ADD
ITEM 4 TO ISSUES LIST

I. INTRODUCTION

Docket No. UM 1182 was recently reopened to continue examining issues of bias in the utility resource procurement process that favors utility ownership of generation assets over a power purchase agreement (PPA) with an independent power producer (IPP). In Order No. 11-001, the Commission accepted the premise that there is a bias towards a utility benchmark resource in the evaluation of bids, but determined that the scope and impact of the bias is undetermined. This second phase of this reopened docket addresses competitive bidding guideline 10(d).

Guideline 10(d) requires an independent evaluator (IE), hired for a particular request for proposals (RFP), to evaluate the unique risks and advantages of a utility benchmark resource. Unsatisfied with past IE evaluation of the comparative risks and advantages of utility benchmark resources, the Commission stated:

We want a more comprehensive accounting and comparison of all of the relevant risks, including consideration of construction risks, operation and performance risks, and environmental regulatory risks. We also want more in-depth analysis of all of these risks. We invite comment on the analytic framework and methodologies that should be used to evaluate and compare resource ownership to purchasing power from an independent power producer.¹

¹ Order No. 11-001 at 6 (Docket No. UM 1276).

Parties held workshops to discuss the Commission's directives, identifying a list of twelve comparative risks or advantages (items) to consider. Consensus was not reached, however, on a reduced list to initially consider. Parties filed comments recommending reduced lists. On May 30, 2012, the administrative law judge (ALJ) issued a ruling (ALJ ruling) that established a list of three items for initial analysis. The ruling adopted Staff's recommendation to initially address the following: Items 1 (Cost Over- or Under-Runs), 11 (Counterparty Risk), and 12 (Heat Rate Degradation). The ALJ acknowledged the interest "in addressing reduced performance more generally by considering both thermal and wind resources," but decided to initially keep the focus on three discrete items.²

On June 14, 2012, the Northwest and Intermountain Power Producers Coalition (NIPPC) requested certification of the ALJ ruling to the Commission. NIPPC asked the Commission to reconsider the issues list and order that Item 4 (Wind Capacity Factor) replace Item 11 (Counterparty Risk). NIPPC indicates support for the request for certification from the Citizens' Utility Board of Oregon (CUB) and the Industrial Customers of Northwest Utilities (ICNU).

On June 21, 2012, Portland General Electric Company, Pacific Power, and Idaho Power filed comments in opposition to the request for certification. Without addressing whether certification was required or needed, the ALJ certified the ruling to allow the Commissioners an opportunity to determine what issues to initially address in this phase of the docket.

II. PARTIES' POSITIONS

Staff's position is that the Commission's initial analysis should focus on no more than three key factors. Staff used the following criteria to analyze each of the twelve factors to choose three factors: (1) the level of interest demonstrated by the parties; 2) the factor's effect on bid scoring; 3) the availability of data to analyze a factor; and 4) the ability to analyze a factor in a reasonable period of time. Using these criteria, Staff recommended the Commission initially analyze Items 1 (Cost Over- or Under-Runs), 11 (Counterparty Risk), and 12 (Heat Rate Degradation).

The utilities agreed to start with three items and to include counterparty risk as one of the items. The utilities asserted that counterparty risk is important due its potential effect on virtually all of the other items, and its possibly significant impact on customers. The utilities also recommended that the Commission initially analyze the residual or terminal value of an asset, which is a subset of Item 2 (End Effects).

NIPPC agreed with Staff that the Commission should initially consider capital cost overruns. NIPPC also agreed with Staff that the Commission should initially address lower than expected plant performance, but proposed that the Commission do so by considering two items: heat rate degradation of thermal resources (Item 12) and declining capacity factors for wind resources (Item 4). Rather than consider counterparty

² ALJ Ruling at 4 (May 30, 2012).

risk, NIPPC wanted the Commission to analyze Item 7 (Increases in Fixed O&M Costs Over Time). ICNU concurred with NIPPC's recommendations. CUB expressed support for NIPPC's proposal to focus on evaluating, with actual data, the likeliness of cost overruns for utility resources, and providing an advantage to IPPs in the bidding process. In asking for certification of the ALJ ruling, NIPPC reduces the list of recommended items to three, but requests the Commission remove Item 11 (Counterparty Risk) and add Item 4 (Wind Capacity Factor). NIPPC indicates that CUB and ICNU support this request. NIPPC argues that a limited list of items should only "focus on the Commission's stated concern that the competitive bidding process is currently prejudiced in favor of utility ownership."³ NIPPC asserts that the utilities appear to intend to develop Item 11 in a manner that would increase the self-build bias which is counter to the Commission's goals for the docket.

In response, PGE argues that the Commission did not intend the sole focus of the docket to be on "determining ways to increase the cost of self-build bids."⁴ PGE observes that Order No. 11-001 calls for "analytical rigor" in comparing resource ownership to power purchases that cannot be "achieved by looking only for benefits to IPPs and turning a blind eye to corresponding risks."⁵ PGE also observes that counterparty risk is a detriment to an IPP over a utility only if the IPP's financial strength is worse than that of the utility. Pacific Power observes that analysis of counterparty risk will also allow the Commission to fairly evaluate risks associated with one IPP versus another. Idaho Power asserts that inclusion of Item 4 may be problematic due to the evolving nature of wind forecasting methods, and advises waiting to address this item.

III. RESOLUTION

The ALJ ruling was based on an understanding that we had "directed parties to determine an analytic framework and methodologies to better evaluate and compare utility ownership of resources to the purchase of power from IPPs."⁶ With an awareness of our intent to improve full evaluation and comparison of the resources, the ruling determined that Staff's analysis of the items to be initially addressed was appropriate because it was determined based on evaluative criteria such as the effect on bid price and the availability of data, and because it allowed analysis of the risks and benefits of both types of resources. We agree with the ALJ ruling of May 30, 2012, and affirm it, with one modification.

The ruling acknowledged the interest in addressing the potential reduced performance of resources generally by considering both thermal and wind resources upfront, but deferred to Staff's advice to initially address only three items. In the interest of a fuller analysis upfront, however, we will add Item 4 (Wind Capacity Factor) to the Issues List.

³ NIPPC Request for ALJ Certification at 3.

⁴ PGE Comments in opposition to NIPPC's Request for ALJ Certification at 2.

⁵ *Id.*


⁶ ALJ Ruling at 4.

IV. ORDER

IT IS ORDERED that:

- 1. The Administrative Law Judge ruling dated May 30, 2012, attached as Appendix A, is affirmed with modification to add consideration of declining capacity factors for wind resources (Item 4) to the Issues List.
- 2. Phase II of this reopened docket shall consider: Items 1 (Cost Over- or Under-Runs), 4 (Wind Capacity Factor), 11 (Counterparty Risk), and 12 (Heat Rate Degradation).


Made, entered, and effective AUG 23 2012.



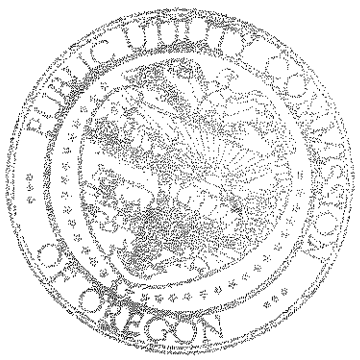
Susan Ackerman
 Chair



John Savage
 Commissioner



Steven Bloom
 Commissioner



A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480 through 183.484.

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1182

In the Matter of

NORTHWEST AND INTERMOUNTAIN
POWER PRODUCERS COALITION

Petition for an Investigation Regarding
Competitive Bidding.

RULING

DISPOSITION: ISSUES LIST ESTABLISHED FOR PHASE II

I. BACKGROUND

In Docket UM 1182, the Commission addressed issues of bias in the utility resource procurement process favoring utility ownership of generation assets over power purchase agreements (PPAs) with an independent power producer (IPP). In Order No. 11-001, the Commission accepted the premise that there is a bias towards a utility's benchmark resource in the evaluation of bids, but determined that little had been established about the scope and impact of the bias. Indeed, the Commission concluded that "[w]e do not know whether the current regulatory process has, in fact, failed to prevent the utilities from acquiring higher cost, utility-owned resources."¹ Consequently, the Commission declined to adopt, at the time, any methodologies proposed to counter the bias.

Instead, the Commission reopened Docket UM 1182 to further evaluate, in two separate phases, certain issues related to the competitive bidding guidelines for utility resource acquisitions adopted in that docket. In particular, the Commission called for reconsideration of Guidelines 11 and 10(d). The docket was divided into two phases to address each guideline. This second phase addresses Guideline 10(d).

Guideline 10(d) requires an independent evaluator (IE) hired for a particular request for proposals (RFP) to evaluate the unique risks and advantages of a utility benchmark resource. Unsatisfied with past IE evaluation of the comparative risks and advantages of utility benchmark resources, the Commission stated:

We want a more comprehensive accounting and comparison of all of the relevant risks, including consideration of construction risks, operation and performance risks, and environmental regulatory risks. We also want more in-depth analysis of all of these risks. We invite comment on the

¹ Order No. 11-001, p. 5.

analytic framework and methodologies that should be used to evaluate and compare resource ownership to purchasing power from and independent power producer.²

Parties held workshops to discuss the Commission's directives. In the first workshop, parties identified a list of twelve comparative risks or advantages (items) to consider, as follows:

Item 1 – Cost Over- or Under-Runs: An IPP contractually guarantees construction cost, while a utility Benchmark resource may have cost over- or under-runs that are allowed into rates.

Item 2 – End Effects: An IPP contractually agrees to provide power for a certain period with no further costs and benefits beyond the contract termination date, but a benchmark resource may include costs and benefits that extend beyond the period of expected operation—e.g., cost of site restoration, value of potential further operation, etc.

Item 3 – Environmental Regulatory Risk: Ratepayers pay for the costs associated with changes in environmental regulations, whereas the responsibility of an IPP will depend upon the terms of the contract.

Item 4 – Wind Capacity Factor: Assuming neither cost over- nor under-runs, customers simply pay the bid capital costs of a benchmark wind resource and receive the value of the wind energy produced. However, under an IPP “per MWh” contract, customers could pay either more or less than the actual capital costs.

Item 5 – Construction Delays: An IPP can mitigate construction delays with contractual damages, while ratepayers do not pay for the capital costs of a project until completion, but must replace the lost power.

Item 6 – Changes in Forced Outage Rates Over Time: An IPP can mitigate forced outages with contractual damages, while ratepayers are at risk for opportunity costs associated with forced outages for a benchmark resource.

Item 7 – Increases in Fixed O&M Costs Over Time: An IPP can contractually guarantee the level of operation and maintenance (O&M) costs for a resource over the period of the contract while ratepayers pay for prudently incurred O&M costs for a benchmark resource life regardless of expectations.

Item 8 – Capital Additions Over the Resource Life: An IPP can contractually guarantee the level of capital additions for a resource over the period of the contract while ratepayers pay for prudently incurred and cost-effective capital additions over a benchmark resource life regardless of expectations.

Item 9 – Changes in Allowed Return on Equity Over the Resource Life: A benchmark resource has a varying return on investment compared to the known total cost for an IPP resource.

² Order No. 11-001 at6.

Item 10 – Verify Output, Heat Rate, and Power Curve at the Start of Resource Life: Although there are established performance verification protocols for various resource types, they cannot be applied to either IPP or benchmark resources until resource completion.

Item 11 – Counterparty Risk: Financial performance risks of an IPP may be higher than a utility.

Item 12 – Heat Rate Degradation: An IPP can contractually guarantee a heat rate, while ratepayers are at risk that the heat rate of a benchmark thermal resource increases more than anticipated over time.

At a subsequent workshop, Staff asked the parties to work to reduce the list to two or three items to initially address. In a status report filed on February 22, 2012, Staff informed the Commission that the parties had not reached consensus regarding a limited number of items to address, but would make individual recommendations. Parties filed comments on March 19, 2012.

II. Parties' Positions

While there is generally consensus among the parties that it is appropriate for the Commission to initially consider less than all twelve of the identified factors, there is no general consensus about what factors to address.

Staff used the following four criteria to analyze each factor and chose three to focus on first: (1) the level of interest demonstrated by the parties; 2) the factor's effect on bid scoring; 3) the availability of data to analyze a factor; and 4) the ability to analyze a factor in a reasonable period of time. Using these criteria, Staff recommends the Commission initially analyze Items 1 (Cost Over- and Under- Runs), 11 (Counterparty Risk), and 12 (Heat Rate Degradation).

The utilities agree with Staff that the Commission's initial analysis should focus on no more than three key factors. The utilities also agree that counterparty risk should be one of these factors, asserting that counterparty risk is important because it can affect virtually all of the other factors on the list and have a significant impact on customers. The utilities also recommend that the Commission initially analyze the residual or terminal value of an asset, which is a subset of Item 2 (End Effects). The utilities assert that the terminal value of an asset can be quantitatively determined using established financial valuation methods and can have significant custom effects.

NIPPC agrees with Staff that the Commission should initially consider capital cost overruns. NIPPC also agrees with Staff that the Commission should initially address lower than expected plant performance, but NIPPC recommends the Commission simultaneously analyze heat degradation of thermal resources (Item 12) and declining capacity factors for wind resources (Item 4). Rather than consider a factor suggested by the utilities—i.e., counterparty risk, NIPPC argues that the Commission should analyze Item 7 (Increases in Fixed O&M Costs Over Time).

ICNU's list of four items to initially address is the same as NIPPC. ICNU recommends the Commission initially consider whether potential capital cost overruns of utility resources are being under estimated during the first five years of operation. ICNU also recommends analyzing

how to account for the potential declining performance of utility owned thermal and wind generation. ICNU also suggest the Commission look at increased O&M costs for utility resources.

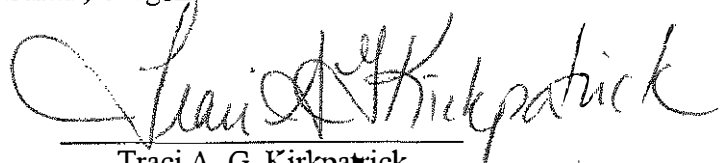
CUB indicates it is appropriate to evaluate, with actual data, the likeliness of cost overruns for utility resources.

III. Ruling

The Commission directed parties to determine an analytic framework and methodologies to better evaluate and compare utility ownership of resources to the purchase of power from IPPs. Parties agreed to approach this endeavor by initially analyzing discrete differences between the two options that may have comparative risks or advantages to determine whether there is a way to quantify such risks or advantages. Twelve items of interest were identified. To focus the analysis, Staff proposes considering three items up front.

Staff's analysis of best items to address first, using evaluative criteria such as effect on bid price and availability of data, is persuasive. Staff's recommendation to address three items, with inclusion of at least one item from each proposed list, is reasonable. Consequently, I adopt Staff's recommendations to initially consider three factors: Items 1 (Cost Over- and Under-Runs), 11 (Counterparty Risk), and 12 (Heat Rate Degradation). Although I understand the interest in addressing reduced performance more generally by considering both thermal and wind resources, I find it better to start with three discrete items.

Dated this 30th day of May, 2012, at Salem, Oregon,



Traci A. G. Kirkpatrick
Administrative Law Judge