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

September 13, 2007

VIA Electronic Mail & U.S. Mail

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

Re: UM 1276

Enclosed are NIPPC's Bias Proposal and NIPPC's version of the CIM/pp incentives proposal (NIPPC Melded Proposal). 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 document upon all parties of record in UM 1276 by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to all parties or attorneys of parties, on the service list compiled by the OPUC.

Dated this 13th day of September, 2007.

/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**	
	KIMBERLY PERRY	520 SW SIXTH AVENUE, SUITE 830 PORTLAND OR 97204 kim@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 COUNSEL	825 NE MULTNOMAH SUITE 2000 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	
	RATES & REGULATORY AFFAIRS	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

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 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.

[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.

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.

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.

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[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.

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.

UM 1276
Northwest and Intermountain Power Producer's Coalition (NIPPC)

Incentives for New PPAs Based Upon Oregon Conservation Incentive Model
CIM/pp (Conservation Incentive Model for purchased power)

September 13, 2007

The proposal below is NIPPC's preferred approach to use of a DSM-like incentive mechanism for PPAs. NIPPC's approach is based on PacifiCorp's initial proposal in this docket with key differences.

Concept: Incent Oregon utility acquisition of new Power Purchase Agreements (PPAs) by applying Oregon's model for conservation incentives, treating PPA expenditures similarly to Demand Side Management (DSM) expenditures.

Background: The Commission issued a series of orders in the late 1980's and early 1990's designed to encourage utility DSM expenditures by allowing demand-side expenditures to be treated as comparable to supply-side expenditures applicable toward rate base. The goal of PPA incentives is similar, in that they are designed to allow comparable regulatory treatment of two types of resources.

To remove the disincentive to invest in new DSM, the Commission allowed capitalization of all DSM expenditures (both capital and expense). The Commission also allowed amortization of these expenditures, with a return, over the life of the DSM program. *See In re PacifiCorp and PGE Conservation Program Expenses*, Order No. 89-1700 (1989). In this manner, the Commission established comparability between utility expenditures in DSM and utility investment in new generation plant.

The Commission recognized, however, that eliminating the disincentive to invest in DSM was insufficient to incent utility behavior because this, at best, left utilities indifferent. Thus, the Commission also allowed utilities to seek additional incentives to make DSM expenditures more attractive than traditional supply-side investment. The Commission decided that these incentive mechanisms should be, at least to some degree, utility specific because a mechanism can only function as an incentive if the entity sought to be encouraged views it as such.

The Commission gave five specific policy goals for these additional incentive mechanisms: (1) symmetrical rewards and penalties; (2) specific benchmarks; (3) proportionate rewards/penalties; (4) significant but not excessive incentives; and (5) savings should be based on best estimates and not subject to after-the-fact true-up adjustments. *In re Electric Utility Incentives for Acquisition of Conservation Resources*, UM 409, Order No. 92-1673 (1992).

Recently, UM 1056, the Commission adopted Guideline 13(a), which requires utilities to assess in their integrated resource plans (IRPs) the advantages and disadvantages of owning a resource instead of purchasing power. *In re Investigation into Integrated Resource Planning Requirements*, Order No. 07-022 (2007). In UM 1182, the Commission adopted a requirement that resources with a duration of 5 years or longer, and 100 MW or greater, referred to as "major resources," be acquired through an RFP. *In re Investigation Regarding Competitive Bidding*, Order No. 06-446 (2006). The Commission has an opportunity in this docket to adopt incentive policies that reinforce the OPUC's prior decisions in UM 1056 and UM 1182 regarding resource planning and acquisition for Oregon consumers.

Proposal:

- Allow utilities to capitalize expenditures associated with PPAs executed after the date of an Order in this docket that are 100 MW or greater and have a delivery term of five-years or longer. Utilities may seek acknowledgement of application of the CIM/pp incentive at the time of RFP acknowledgment.

- To be eligible for this incentive, the PPA
    - must be prudent,
    - 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,
    - must place on the seller certain project development (as applicable), performance, or operational risks that utility customers would most likely absorb if the asset were constructed or owned by the utility. Such risks may 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 to be explicitly identified by the utility at the time of RFP acknowledgement, and
    - must identify, as the source of the PPA supply, specific asset(s) by unit(s), and the 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.

- The delivery term of a PPA is the time period between the date that capacity and/or energy is first made available, delivered, or received to the date that capacity and/or energy is last made available, delivered, or received.

- The term of a PPA is the time period between the first date that the PPA is contractually effective until the date that the PPA is terminated.

- Utilities will derive the capitalized amount by determining the net present value (NPV) of pre-determined PPA expenditures during the PPA term using the utility's average cost of debt. These pre-determined payments are sometimes referred to as "capacity" payments in PPAs. Utilities should use the same NPV calculation currently in use by S&P in imputing debt related to PPAs, which applies a discount rate based on the utility's average cost of debt; alternatively, another NPV calculation approved by the Commission may be used.

- Where a PPA does not have pre-determined expenditures, the capitalized amount will be determined by using the S&P method for determining a proxy capacity component. Except for PPAs associated with wind power resources, the capitalized amount of a PPA shall be capped at 50% of the total of PPA expenditures.

- Capitalization capped at 50% of PPA expenditures is poorly suited to PPAs associated with wind resources since such intermittent resources have costs that are largely fixed. Therefore, for a PPA associated with wind resources, the CIM/pp will capitalize 95% of the NPV of the PPA's expenditures. For a PPA associated with other renewable resources, the CIM/pp will capitalize PPA expenditures proportionate to the relative level of fixed costs to total costs typical for that type of resource.

- If the PPA and any applicable CIM/pp proposal have been acknowledged by the Commission following a UM 1182 acknowledgement filing, recognize AFPPA (Allowance for Funds used for PPAs), from the beginning of the term of the PPA, using the utility's AFUDC rate as of the execution date and calculated on a post-tax basis, for capitalized portion of new PPAs before costs are reflected in rates.

- In rate case or annual net variable power cost update, allow utilities to amortize the capitalized portion of PPA expenditures, plus AFPPA, over the term of the PPA.

- Allow utilities to earn a return on the unamortized balance of the capitalized portion of PPA expenditures at the utility's allowed ROR, calculated on a pre-tax basis.

- Unless otherwise allowed by law or Commission order, PPAs are subject to a prudence review before the capitalized portions of PPA expenditures can be reflected in rates.

- If the Commission adopts NIPPC's proposal (attached) to mitigate utility bias at the time of RFP evaluation, then the cost of the CIM/pp will be considered in determining the short list in an RFP and considered at the time the Commission acknowledges the RFP short list. If the Commission does not adopt the NIPPC proposal, then the cost of the CIM/pp incentive will not be considered in determining the short-list in an RFP, nor will it be considered at the time the Commission acknowledges the RFP short-list.

- Allow utilities to propose additional utility-specific PBR mechanisms for PPAs using policy goals for incentive mechanisms from UM 409. This could incorporate other proposals developed in this docket.

Benefits: The CIM/pp benefits customers by incenting utilities to acquire PPAs that provide customers with resource options and that absorb resource development or operational risks of significance to consumers. Utility acquisition of new PPAs can contribute to the development and maintenance of a robust competitive wholesale market, which ultimately may provide customers greater resource choices.

The CIM/pp is limited in scope in that it only applies to: (1) new PPAs; (2) PPAs with delivery terms of five years or more duration and at least 100 MW that have been selected in a competitive solicitation, and (3) the capitalization of the portion of PPA expenditures associated with fixed costs of the PPA is capped at 50% of the total except for wind PPAs. These limitations moderate the rate impact of the CIM/pp. At the same time, CIM/pp can reasonably be expected to be effective in reducing future imputed debt and associated costs because S&P imputes debt on the portion of PPA expenditures that S&P associates with debt (*i.e.,* the pre-determined expenditures). From a qualitative standpoint, the CIM/pp should allow for the maintenance of the credit quality of Oregon utilities and lower the potential costs of capital for new utility investment.

Under the CIM/pp, PPA expenditures will not be reflected in rates until a prudence review is conducted or otherwise allowed per law or Commission order. Thus, the CIM/pp maintains the regulatory discipline of the risk of a prudence disallowance.

This approach uses a tried and tested framework to incent Oregon utilities to invest in supply-side alternatives to rate based generation resources. The CIM/pp is straightforward, easily implemented for all utilities, and allows for utility-specific tailoring of incentives beyond those designed to treat PPAs and rate base generation comparably for regulatory purposes. The approach strengthens the Commission's existing policies on utility resource planning and acquisition because it limits the availability of the incentive to resources selected in an RFP and using criteria consistent with integrated resource planning analysis.

The Commission should review the CIM/pp mechanism after five years, but the result of its review should not affect the recovery in rates of any PPA or associated CIM/pp incentive previously approved by the Commission under this mechanism.

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