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March 11, 2013

VIA ELECTRONIC FILING
AND OVERNIGHT DELIVERY

Public Utility Commission of Oregon
550 Capitol Street NE, Suite 215
Salem, OR 97310-2551

Attn: Filing Center

Re: UM 1182 – PacifiCorp's Post-Hearing Brief

PacifiCorp d/b/a Pacific Power submits for filing an original and five copies of its Post-Hearing Brief in the above-referenced proceeding.

Please direct informal correspondence and questions regarding this filing to Bryce Dalley, Director, Regulatory Affairs & Revenue Requirement, at (503) 813-6389.

Sincerely,

William R Griffith/R

William R. Griffith
Vice President, Regulation

Enclosures

cc: UM 1182 Service List

CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document, in Docket UM 1182, on the date indicated below by email and/or US Mail, addressed to said parties at his or her last-known address(es) indicated below.

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DATED: March 11, 2013

Carrie Meyer
Supervisor, Regulatory Operations

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1182

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Investigation Regarding Competitive Bidding	PACIFICORP'S POST-HEARING BRIEF

PacifiCorp, d/b/a Pacific Power (PacifiCorp or Company) submits this post-hearing brief in accordance with Administrative Law Judge (ALJ) Traci Kirkpatrick's Pre-Hearing Conference Memorandum issued September 27, 2012.

I. INTRODUCTION

Following a thorough investigation into the perceived bias inherent in the utility resource procurement process in docket UM 1276, the Public Utility Commission of Oregon (Commission) issued Order No. 11-001 in which it declined to adopt any of the proposed incentive mechanisms and closed the docket.[1] Specifically, the Commission found the proceedings failed to quantify the "scope and impact" of any such bias, resulting in the Commission being unable to determine whether any of the proposals in docket UM 1276 would mitigate the bias without improperly rewarding utilities and unfairly harming customers.[2] Although the Commission did presume the existence of two narrow sources

[1] *In re Public Util. Commission of Oregon Investigation Regarding Performance-Based Ratemaking Mechanisms to Address Potential Build v. Buy Bias*, Docket No. UM 1276, Order No. 11-001 at 5 (Jan. 3, 2011) (Order 11-001).
[2] *Id.*

of bias in favor of utility-owned projects,[3] the Commission did not find that the utility's bid solicitation process was biased.

Although the Commission declined to adopt a specific proposal in docket UM 1276, it turned its focus to the competitive bid solicitation process with a goal of improving the bid evaluation process. It reopened docket UM 1182 to further investigate the Independent Evaluator's (IE) evaluation of the unique risks and advantages of utility benchmark resources as compared to purchasing power from an independent power producer (IPP).[4]

In response to this direction, the Northwest and Intermountain Power Producers Coalition (NIPPC) proposed that the Commission adopt pre-determined, quantitative generic bid adjustments to apply to utility benchmark resources. The Company recommends that the Commission reject these proposals. The Company agrees with Commission Staff (Staff) that NIPPC has provided no credible evidence of any bias in the evaluation process, undermining NIPPC's claimed need for bid adjustments.[5] Moreover, as explained extensively in testimony by parties to this docket, NIPPC's recommendations are based on flawed data and methodologies and are unsupported by the evidence NIPPC presents. Rather than improving the competitive bidding process, NIPPC's proposals ignore the unique risks and advantages of utility benchmark resources and serve to

[3] The Commission identified two sources of bias: 1) the fact that utility-owned resources allow a utility an opportunity to earn a return while power purchase agreements (PPAs) do not; and 2) the fact that rating agencies may treat PPAs as long-term commitments with debt-like obligations, and thereby impute debt equivalency amounts to a utility's balance sheet. *See id.*; *see also* PacifiCorp Pre-Hearing Brief at 1-2.
[4] Order No. 11-001 at 6.
[5] *See* Staff Pre-Hearing Brief at 2-3. NIPPC presumes the Commission has already found a bias, but the Commission was referring in Order No. 11-001to the incentive for a utility to choose a project it could add to rate base, not a finding that bias exists in IE project scoring.

definitively bias the competitive bidding process.[6] NIPPC's proposals do not improve the evaluation of resources; rather, NIPPC's proposed generic bid adjustments preclude the evaluation of resource options based on their individual merits. NIPPC's proposed generic bid adjustments, including the general concept of developing generic bid adjustments, are not in the best interest of utility customers and the Company recommends that the Commission reject them.

The Company is committed to ensuring a consistent, robust, and fair comparison of all bids in the competitive bidding process, and supports the Commission's efforts to evaluate the role of the IE in this process. In the two years since docket UM 1182 was re-opened, the parties have weighed in on the issues through numerous workshops, submitted comments, filed two rounds of testimony, and submitted pre-hearing briefs. However, despite these efforts, little progress has been made toward improving the evaluation of comparative risks of utility-owned and third-party owned resources in future utility requests for proposals (RFPs). Given the lack of progress to this point, the Company recommends that if the Commission wishes the parties to continue their evaluation of the remaining eight items identified for review in this docket,[7] it also direct the parties to develop for Commission approval a policy framework to guide the evaluation process, such as that proposed by the Company in its pre-hearing brief.[8] This will help the parties move forward with a common policy framework on which to base future recommendations.

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[6] As noted by Portland General Electric Company (PGE) in its pre-hearing brief, under NIPPC's proposals, a benchmark resources would face a 44.5 percent adder to the cost of the proposal (cost over-run and counterparty adder), plus an 8 percent heat rate adder or 11 percent wind capacity factor adder. PGE Pre-Hearing Brief at 12-13.
[7] *See* Administrative Law Judge Ruling (May 30, 2012).
[8] PacifiCorp Pre-Hearing Brief at 8-10.

II. DISCUSSION

For the reasons described in the Company's testimony and pre-hearing brief, the Company continues to urge the Commission to reject NIPPC's proposals to include generic bid adjustments in the solicitation process for utility benchmark resources. The Company agrees with Staff's analysis and conclusions, which are that NIPPC's proposed bid adjustments for utility benchmark resources are inappropriate and unjustified.[9] In addition, the Company finds it notable that no party to this docket, with the exception of CUB, is supportive of the concept of generic bid adjustments, and no party, including CUB, supports the data and analysis presented by NIPPC in support of its proposals.[10]

In its testimony and pre-hearing brief, the Company addressed each of the four factors at issue—Wind Capacity Factor, Heat Rate Degradation, Construction Cost Over- and Under-runs, and Counterparty Risk—in detail, including the Company's current risk evaluation process and an explanation of why NIPPC's proposed bid modifications are inappropriate and not in the best interest of customers. The Company also provided recommendations for next steps, if next steps are deemed necessary. The Company will not re-state these analyses and conclusions here; this post-hearing brief addresses only new issues raised by NIPPC and CUB in pre-hearing briefs.

A. Wind Capacity Factor

NIPPC proposes, and CUB supports, a bid adjustment to reduce the capacity factor for proposed utility-owned wind generation projects when comparing utility-owned

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[9] Staff Pre-Hearing Brief at 14.

[10] CUB/100, Jenks-Feighner/5. With respect to NIPPC's proposed capacity factor bid adjustment, CUB states that it "agrees with this approach, although not necessarily with NIPPC's methodology or the actual value of the proposed adder."

projects and IPP bids.[11] NIPPC argues this adjustment is necessary to address utility over-estimation of capacity factor for utility-owned wind generation.[12]

1. NIPPC and CUB's Characterization of Comparative Risks Associated With Wind Capacity Factor is Incorrect

The capacity factor bid adjustment proposed by NIPPC and supported by CUB reflects NIPPC and CUB's misunderstanding of the risk differential between utility wind projects and third-party owned projects as it relates to capacity factor. Both NIPPC and CUB claim that the risk differential for wind capacity factor between utility-owned wind projects and third-party owned projects harms customers because the "IPP is only paid a fixed price per MWh [megawatt-hour] and renewable energy credit produced, while the UOG [utility-owned generation] project passes on all prudent capital costs of the project to ratepayers regardless of actual production."[13] CUB further explains that, for utility-owned generation projects "an assumption of higher capacity factor is beneficial [to the utility], as these projects are rate-based, so customers are charged the same level of investment regardless of generation."[14] CUB goes on to explain that:

> Customers assume the downside risk of higher prices per unit of energy generated, as well as reduction in the number of renewable energy credits (RECs) generated by the project. Customers also receive the benefit of lower net power costs if generation exceeds estimates; however, there is little downside risk to the utility in this situation.[15]

The Company agrees that, assuming a project is deemed prudent, the capital cost of a utility-owned project is included in rate base and the amount included is not tied to actual production. The Company further agrees that IPPs are generally paid a fixed price

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[11] NIPPC/100, Monsen/33.
[12] NIPPC/300, Monsen/39.
[13] NIPPC Pre-Hearing Brief at 15; CUB Pre-Hearing Brief at 12.
[14] CUB Pre-Hearing Brief at 11.
[15] *Id.*

per MWh and REC produced. However, the Company disagrees that this differential necessarily results in harm to customers.

In contrast to the claims of NIPPC and CUB, regardless of whether a resource is utility or third-party owned, the utility bears the risk of differences between the estimated capacity factor and actual availability of a resource because, in either case, the power costs associated with that resource go into rates based on an expected capacity factor. For a utility-owned project, power costs reflected in rates are based on the most recent estimate of resource availability.[16] Similarly, for a third-party owned resource, power costs reflected in rates are based on the per MWh contract price, multiplied by the MWh output at an expected capacity factor. In both cases, unless the utility has a dollar for dollar power cost adjustment mechanism that updates rates to reflect actual capacity factor, the risk associated with forecasting error is borne by the utility, not customers. NIPPC's and CUB's claims fundamentally misunderstand the nature of how customer rates reflect capacity factor forecast errors and thus, incorrectly conclude that the risk differential between utility and third-party owned resources is harmful to customers.

On the other hand, customers do bear some risk that the capacity factor forecast will ultimately result in a higher cost per unit of energy generated. However, similar to the reflection of power costs in utility rates, this is the case regardless of whether the resource is utility-owned or third-party owned. In the case of a utility-owned project, customers do not assume the downside risk of higher prices per unit of energy generated

[16] *In the Matter of PacifiCorp, dba Pacific Power 2009 Renewable Adjustment Clause Schedule 202*, Docket No, UE 200, Order No. 08-548, at 21 (Nov. 14, 2008). ("Although the estimated capacity factor at the time of project approval is dispositive for purposes of prudence review, it is not dispositive for purposes of forecasting resource availability for ratemaking purposes. The most recent reliable data should be used to set rates for the test period, recognizing that such data necessarily will be uncertain, particularly at start-up.")

when generation is less than expected.[17] In the case of third-party owned resources, customers do not assume the downside risk of higher costs when generation is more than expected. The claim that the "risk differential" between utility-owned and third-party owned resources has "undeniably increased actual costs to Oregon ratepayers"[18] lacks any merit or support.

NIPPC's and CUB's claims that Oregon IEs have specifically noted this risk differential are not compelling. In the IE report referenced by NIPPC, Accion Group stated that, with respect to PGE's ownership option, "an ownership option would bear the full impact of this production shortfall, whereas a PPA option would effectively shield customers from most of the cost because the energy price would be fixed."[19] This statement is an over-simplification of how the cost of a utility-owned resource is included in rates. Customers do not necessarily bear the full impact of a production shortfall because the costs are included in rates at the amount expected at the time they are included. Similarly, customers are not necessarily "shielded" from costs associated from a third-party production shortfall unless a dollar for dollar power cost adjustment mechanism is in place.

2. Use of a Capacity Factor Expert Minimizes the Primary Risk to Customers

With respect to wind resources, the primary risk to customers is that the actual production cost will be significantly different from that assumed at the time of resource selection. This risk exists with both utility-owned and third-party owned resources. Therefore, the key issue with respect to wind capacity factor, as the Company has

[17] The Company agrees that customers do risk a reduction in the number of RECs generated, but this risk is the same with utility-owned and third-party owned resources.
[18] NIPPC Pre-hearing Brief at 16.
[19] NIPPC/323, Monsen/5.

repeatedly explained, is to ensure that wind capacity factor estimates for all resources evaluated in an RFP use comparable methodologies during evaluation of the shortlist. For both utility-owned projects and third-party owned projects, capacity factor is a key metric to determine the price of energy per unit generated. Ensuring consistent capacity factor estimates by applying the same methodology ensures that all projects are evaluated on a comparable basis so that the least-cost resource may be identified as accurately and fairly as possible. Employing an independent Wind Capacity Factor Expert to evaluate competitive bids is the best industry practice that the Company is aware of at this time to ensure forecasts are determined using a consistent methodology.[20]

Furthermore, the use of a Wind Capacity Factor Expert is not an acknowledgement of a "problem," or a "bias," or that any alleged errors in wind forecasts are attributable to an incentive to over-forecast wind projection, as NIPPC suggests.[21] Rather, it is an acknowledgment that wind forecasting is a critical, yet to some degree subjective, component of a resource evaluation process. Employing an objective third-party expert to apply the same methodology and criteria consistently to each resource option helps to reduce this inherent subjectivity and ensures a more accurate comparison of resources. This is ultimately in the best interest of customers because it helps ensure that the least-cost, least-risk resource is selected.

B. Heat Rate Degradation

NIPPC proposes an 8 percent heat rate adjustment or use of a heat rate forecast that "reflects anticipated degradation resulting in an 8% increase in the average heat rate over

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[20] PAC/200, Kusters/32.
[21] NIPPC Pre-Hearing Brief at 16.

the bid evaluation period."[22] NIPPC claims this heat rate degradation adjustment is necessary to counteract inaccurate utility estimates of heat rate degradation.[23] NIPPC is the only party to this docket that finds that the evidence presented supports the need for a generic bid adjustment. The Company and other parties, including Staff, have rebutted NIPPC's arguments and analysis in a detailed manner. NIPPC's pre-hearing brief did not include further insight or respond to criticisms made by other parties. Rather, NIPPC continues to assert the same claims relying on the same flawed analysis. The Company has extensively rebutted NIPPC's analysis and will not repeat it here.

1. A Heat Rate Degradation Bid Adjustment is Not Justified

In its pre-hearing brief, NIPPC states that "PacifiCorp's witness even testified that an IPP offering a guaranteed heat rate in a TSA [tolling services agreement] would embed a risk premium into the price of the TSA in the form of a heat rate margin."[24] NIPPC goes on to state that that this "is the reason the bid adder is needed."[25] These statements only reveal NIPPC's misunderstanding of the purpose of a bid solicitation process and a comparative risk evaluation. It does not follow that because risk premiums are embedded into the price of a TSA that "fairness" dictates a corresponding risk premium be embedded into the price of a benchmark resource that does not have the same risk profile. As explained by the Company in its pre-hearing brief, individual resource proposals have different risk profiles.[26] Even among IPPs, the type of heat rate guarantee proposed can change the risk profile associated with that resource option. Contrary to NIPPC's proposal, fairness in the context of a resource solicitation means that each resource option

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[22] NIPPC/100, Monsen/27.
[23] *Id.* at 25.
[24] NIPPC Pre-Hearing Brief at 13.
[25] *Id.*
[26] PacifiCorp Pre-Hearing Brief at 19-20.

is evaluated on its individual merits and risk profile; it does not mean that all resources should have the same risk premiums embedded in their prices regardless of actual risk.

When evaluating the final shortlist, the Company models utility assets with appropriate heat rate degradation curves and part-load performance curves, and considers the costs and benefits of reserves in the Company's planning and risk models.[27] The bid-specific benefits of a TSA guaranteed heat rate, which the Company agrees can be designed to limit customers' exposure to risk for plant underperformance, are attributed to the TSA proposal.[28] In this way, the risks and benefits of each proposal are taken into account based on their individual characteristics. Reviewing resources based on their individual characteristics and risk profiles helps ensure that the least-cost, least-risk resource is accurately and fairly identified. Applying arbitrary risk premiums to ensure "fairness" among resource options would only serve to frustrate this process.

2. Original Equipment Manufacturer Data Provides the Best Available Heat Rate Degradation Information for Purposes of Resource Evaluation

In its pre-hearing brief, NIPPC claims that parties failed to "disprove the overwhelming evidence that heat rate degradation occurs."[29] NIPPC supports this claim by pointing to the fact that no utility provided a quantitative recommendation for heat rate degradation other than the original equipment manufacturer (OEM) projections. The Company has not claimed heat rate degradation does not occur; in fact, the Company has a long standing practice of incorporating heat rate degradation in the resource evaluation process. Rather, the Company did not provide, nor attempt to develop, a quantitative

[27] PAC/100, Kusters/16.
[28] *Id.*
[29] NIPPC Pre-Hearing Brief at 14.

recommendation other than the OEM information because the Company has found that the OEM information is the best available for use in the competitive bidding process.[30]

Heat rate degradation is one of many factors that impacts the overall efficiency of a gas-fired resource. It is challenging, at best, to isolate the impact of heat rate degradation on the factors that influence overall plant performance.[31] Furthermore, a plant's actual heat rate is highly dependent on ambient and operating conditions as well as the type of combustion turbine at issue. In addition, the type of gas turbine that will be used in future resources will be significantly different than those installed in the past, so evaluating historical information to apply to future gas turbines is not appropriate.[32] Consequently, the Company maintains that the OEM information is the best information available and that use of OEM data is the most effective way to ensure that heat rates are appropriately quantified as part of the competitive bidding process.

C. Cost Over- or Under-Runs

NIPPC proposes the use of generic bid adjustments to impute a 7.0 percent increase to the assumed installed costs of a utility-owned project and to impute deferred capital expenditures to the initial plant cost over the first five years of plant operation.[33] According to NIPPC, these bid adjustment are necessary to protect customers from the risk of cost over-runs and utility front-loading of capital costs, respectively. The Company agrees with Staff's assessment that NIPPC's bid adjustment for construction cost over- or under-runs is based on "incorrect facts, an insufficient data base, and, in

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[30] *See* PAC/200, Kusters/27-28.
[31] *Id.*
[32] *Id.*
[33] NIPPC/100, Monsen/12.

some cases, gross-oversimplification of data."[34] The Company has extensively rebutted NIPPC's evidence and will not repeat it here.

1. A Construction Cost Over- or Under-Run Bid Adjustment is Not Justified

In arguing for the development of a generic construction cost over-run bid adjustment, both NIPPC and CUB cite to a recent IE report in which the IE asks the Commission to hold the Company to cost estimates in future ratemaking cases.[35] The problem with a benchmark resource, according to the IE, "is that it is offered on a cost-plus basis while third-party bidders are required to guarantee their price and performance parameters."[36] Both CUB and NIPPC argue that these statements support the development of a generic quantitative method for accounting for risk. However, the statements made by the IE do not demonstrate a need for a quantitative generic bid adjustment and do not address the customer benefit associated with utility cost under-runs.

Rather, these statements highlight the core issue: the difficulty of comparing cost-based resources that are subject to prudence review with resources that are not cost-based or subject to the same level of regulatory scrutiny. Generic bid adjustments applied only to benchmark resources do not account for this complex issue and, like the proposals ultimately rejected in docket UM 1276, involve uncertainty and the potential to improperly reward certain types of resources and unfairly harm customers. In contrast to NIPPC's asymmetrical proposal, the Company has suggested the application of a symmetrical risk-adjusted methodology, reviewed by the IE, to compare the respective

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[34] Staff Pre-Hearing Brief at 9.
[35] NIPPC Pre-Hearing Brief at 7; CUB Pre-Hearing Brief at 7.
[36] *Id.*

risks of the resource alternatives at issue in any given bid solicitation.[37] Such an approach would ensure that the risks *and benefits* of all alternatives are taken into consideration.

In addition, the IE's suggestion that the Commission hold the Company to cost estimates for purposes of future ratemaking does not address the difficulty in comparing resource options and the inherent regulatory compact associated with cost-based regulation. Asymmetrically limiting a utility to a particular amount for purposes of cost recovery is contrary to basic tenets of cost of service regulation.[38] It is likely the Company would only be able to consider such a new form of regulation *if* the approach were symmetrical; that is, if it allowed the Company to benefit from cost under-runs and to propose a fixed cost that fairly incorporated the risk of a cost over-run coupled with the rebuttable presumption of prudence for the proposed fixed cost. While an interesting proposal on the part of the IE, it is not clear to the Company that this approach leads to a clearer understanding of the comparative risks of utility-owned versus third-party owned resources in future RFPs. Rather, similar to the concept of a generic bid adjustments, it is an essentially arbitrary adjustment based on something other than the individual merits of a particular resource proposal. As such, it carries the potential to hinder the selection of the least-cost, least-risk resource.

2. NIPPC's Reliance on Historic Cost Over- or Under-Run Data is Misplaced and Beyond the Scope of This Proceeding

In response to NIPPC's criticism that the Company failed to provide an analysis of its construction cost over- and under-runs until reply testimony, the Company notes that it

[37] PAC/100, Kusters/23.

[38] *See e.g. In re Portland Gen. Elec. Co.*, 8 P.U.R.4th 393, 415 (Dec. 23, 1974) ("The touchstone of rate making, and of the commissioner's responsibility to prevent rate discrimination, is the concept that each customer should pay the costs imposed upon the company in meeting that customer's energy needs.")

raised this information on reply because its purpose was to counter the inaccurate claims made in NIPPC's direct testimony. The Company maintains that the purpose of this docket is to improve the comparative evaluation of utility benchmark resources, not to calculate bid adders. It has consistently held that historic data regarding construction cost over- and under-runs, and the application of such data to develop generic bid adjustments, are not directly relevant to the goals of this docket. The evaluation of the comparative risks of different resource options should not require extensive fact-finding or utility construction cost analyses.

D. Counterparty Risk

In its discussion of counterparty risk, NIPPC proposes to eliminate the evaluation of counterparty risk prior to the execution of a PPA. This proposal is neither practical nor in the best interest of customers. Companies with higher credit ratings are deemed less risky because they are financially healthier and thus better able to ensure contract performance. Eliminating or downplaying this criterion would help third-party bidders win RFPs, but it would result in a less robust IE evaluation and expose ratepayers to unnecessary financial risk.

Moreover, as PGE explains, delaying credit scoring until after execution of a PPA is not practical because it would result in false starts.[39] If the counterparty is unable to establish credit, the utility may have lost the opportunity to pursue alternate bids.[40] The Company has made specific recommendations about the appropriate evaluation of

[39] PGE Pre-Hearing Brief at 32.
[40] *See id.*

counterparty risk during different stages of the RFP process, and asks the Commission to consider them.[41]

The Company also recommends that a contract template with non-negotiable terms be developed for use in the bidding process.[42] Customers would benefit from non-negotiable contract terms because this would result in IPPs bidding into a RFP already knowing the expected balance of cost and risk between the buyer and seller. PGE and Idaho Power Company have endorsed this approach as well. NIPPC opposes this approach because "development of reasonable terms would require a level of oversight of the RFP process that the Commission's current policies do not allow.[43] However, many of NIPPC's claims about the relative benefits of IPP projects hinge on their ability to absorb risk, and the primary legal basis for this assumption of risk are the terms and conditions of the IPP's specific contract. The rationale for NIPPC's proposed bid adjustments relies heavily on these assumed contractual benefits of third-party owned resources, which in turn go hand-in-hand with firm assurances that these benefits will actually be realized. As such, NIPPC's proposed bid adjustments could only feasibly be adopted with additional Commission oversight to develop contractual terms and conditions that ensure that the benefits that constitute the basis for the adjustments are captured in the applicable contract.

III. CONCLUSION

The Company asks the Commission to reject NIPPC's request to apply pre-determined, asymmetrical generic bid adjustments to benchmark resources. Instead, the Company asks the Commission to consider the Company's recommendations and to direct

[41] PacifiCorp Pre-Hearing Brief at 37-38.
[42] *Id.* at 38.
[43] NIPPC Prehearing Brief at 19.

additional process if the Commission believes it would be helpful. Ultimately, requiring the IE to evaluate bids on a case-by-case basis, rather than with generic bid adjustments, will best further the goals of this docket; namely, to develop a more comprehensive accounting and comparison of all of the relevant risks between benchmark resources and IPPs in the competitive bidding process.

Respectfully submitted this 11th day of March, 2013.

By: Mary M. Wiencke

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