

**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 an 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 at 6.

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