BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	)	
PACIFICORP for a Certificate of	)	
Convenience and Necessity Authorizing	)	Docket No. 03-035-29
Construction of the Currant Creek	)	
Power Project	)	

REBUTTAL TESTIMONY OF HOWARD FRIEDMAN

FEBRUARY 11, 2004

I. INTRODUCTION

Q. Please state your name, business name, and business address.

A. My name is Howard Friedman. I am employed by Navigant Consulting Inc. My business address is 77 South Bedford Street, Suite 400, Burlington, Massachusetts 01803.

Q. Please describe your educational and business experience.

A. I received a BA degree in Government from Franklin and Marshall College. I also received a Masters in Urban Affairs with a concentration in energy and economics from Virginia Tech. From 1993 to 1995, I worked for the Iowa Department of Natural Resources where I focused on issues related to energy forecasting, energy data analysis, emergency preparedness, energy efficiency, and renewable energy development. In 1995, I took a position with DynCorp Information and Engineering Technology where I worked primarily on energy and environmental issues relating to the deployment of utility technologies for the U.S. Department of Energy and the Environmental Protection Agency. In 1997, I took a position with mc^2, the competitive gas and electric retail-marketing arm of MidCon Corporation where I represented the company in regulatory sessions and proceedings in support of retail gas and electric competition. In 1998, I took a position with Metzler and Associates, which became Navigant Consulting Inc., where I am now a Principal. In this position, I have advised more than twenty different domestic and international energy companies in the areas of asset acquisition and divestiture, supply planning, regulatory and business strategy, energy commodity marketing, and decision analysis.

Q. What RFPs and formal supply solicitations have you and Navigant been involved in over the past three years?

A. I have directly been involved in three RFPs including this one. The two other recent engagements have been RFPs issued by Puget Sound Energy and Wisconsin Electric. Experience that was tapped within Navigant to validate the reasonableness and fairness of PacifiCorp's RFP process included personnel that worked on more than a dozen other recent supply solicitations for such clients as the Long Island Power Authority, Xcel Energy, TXU and Reliant.

Q. Has Navigant been involved in any other relevant supply planning and solicitation work that was leveraged in support of this RFP engagement?

A. Yes. During the course of managing this work for PacifiCorp, we consulted others within Navigant that have advised clients on bidding into RFPs, managed the acquisition and sale of development projects and existing facilities as well as others who have managed both short and long-term supply solicitations on behalf of clients. Exhibit UP&L ____ (HLF-1R) lists some of the other RFP projects on which Navigant has consulted.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to specific comments made by other witnesses as well as provide an independent opinion, as it pertains to assertions made by various witnesses, regarding the implementation and administration of PacifiCorp's 2003-A Request for Proposals (RFP) from the perspective of the Outside Evaluator.

Q. What are the specific topics you plan to address in your rebuttal testimony?

A. The specific areas I will address include: (1) the process used by PacifiCorp to evaluate offers and benchmark them against the NBA; (2) the reasonableness of the economic methodology applied by PacifiCorp to financially evaluate the offers; (3) the consistency and fairness with which PacifiCorp treated each bidder in the RFP; (4) the relevance of new material bid information; and, (5) responding to suggested enhancements that should be made to future solicitations.

II. SCREENING & BENCHMARKING OF OFFERS RELATIVE TO THE NBA

Q. What is your position regarding the manner by which PacifiCorp screened and benchmarked offers in the RFP process?

A. PacifiCorp followed a reasonable and consistent approach to screening offers in the RFP. PacifiCorp also made a concerted effort to clarify ambiguous or missing bid information while giving bidders multiple opportunities to enhance and modify the various offers that would be benchmarked against the NBA.

Q. How do you respond to Mr. Falkenberg's contention that the foundation of the comparative evaluation process was faulty due to PacifiCorp's use of a phased-in simple-cycle to combined-cycle facility that was identified as the least cost option for meeting PacifiCorp's stated need for daily dispatch flexibility by 2005?

A. It is puzzling to me that Mr. Falkenberg would suggest that a higher heat rate facility, which by its nature is less efficient, should be the option that PacifiCorp should have used for the sole purpose of lowering the competitive bar for bidders. During the course of identifying the most economic self-build alternative for meeting the 2005 daily dispatch need, the phased facility that was proposed by

PacifiCorp and validated by Navigant was clearly the most economically attractive alternative. It is not appropriate to penalize ratepayers by forcing PacifiCorp to use a simple-cycle combustion turbine facility as the benchmark, when PacifiCorp was clearly looking for a facility that was flexible enough to meet a daily dispatch and could be on-line by 2005. PacifiCorp's NBA could satisfy both of these requirements. These requirements were explicitly identified in both the RFP and the Pre-Bid Workshop materials. It is simply wrong to assume that only simple-cycle machines could meet such a requirement.

Q. Should PacifiCorp have identified that it would be using a phased-in simple cycle to combine cycle project as the basis for benchmarking offers on an economic basis?

A. No. PacifiCorp had not finalized the alternative that it would be using as the benchmark in this bid category until after the RFP had been issued since the Company was still collecting cost information about each of the possible alternatives that it could consider developing by the target date. The decision to use the benchmark NBA that it did was made subsequent to the issuance of the RFP, but prior to the receipt of any competitive proposal information from bidders. Given the lengths to which PacifiCorp went to communicate to bidders what resource attributes proposals should possess, it would not have been necessary to also publish the exact type of facility being considered by PacifiCorp.

Q. Is it fair to say that the use of the word "peaker" to describe the 2005 bid category was inappropriate?

A. No. Notwithstanding the fact that this was a label to describe a resource requirement, there are several reasons why PacifiCorp's use of this label was not inappropriate. First, PacifiCorp put forth the time and effort to ensure bidders were aware of what the Company was looking for in terms of the operational capabilities of a proposal in the RFP, the Pre-Bid Workshop materials, and the RFP Question and Answer website. Second, it is common industry knowledge that simple cycle and combined cycle facilities can both meet a daily dispatch requirement. Third, as evidenced by the offers submitted by Spring Canyon and Duke, the label did not dissuade bidders from submitting similar equipment configurations to the NBA. Fourth, the phased-in approach proposed by PacifiCorp is not a first-of-its-kind design.

Q. Was it necessary for bidders to deviate from the RFP or ignore the basic requirements in order to submit an economically competitive offer?

A. No. Bidders merely had to price their offer in a way that struck a prudent balance between the value to be retained by the seller and the value that would accrue to the buyer over the expected life of whatever asset they planned to rely upon as the basis for their proposed deal. In fact, all bidders should have focused on the detailed requirements laid out in the RFP and the Pre-Bid Workshop presentation rather than the label that was given to this bid category.

Q. Is it common industry practice during the consideration of asset acquisitions and/or long-term power purchase agreements to go through a phase of due diligence before beginning earnest negotiations?

A. Yes. In the case of asset acquisition engagements and long-term power purchase discussions in which I have been directly involved, they always entail a beginning period of due diligence. Based on an informal poll of other consultants within Navigant that have done similar work, it was unanimously expected that clients would initiate a period of due diligence before discussing any price or non-price terms that were to be negotiated.

III. REASONABLENESS OF THE ECONOMIC MODELING

Q. Some witnesses have contended that the economic modeling of offers by PacifiCorp has fallen short of allowing the Company to identify the least cost alternative for ratepayers. Is this true?

A. No. PacifiCorp appropriately used detailed economic dispatch models that it developed internally as the means to screen the nearly 100 offers that it received in response to the RFP. The tools used by PacifiCorp allowed it to use the exact same types of inputs and operating information to derive the net present value revenue requirement for each alternative. These models take into account both the costs and market revenues associated with the investment over its expected life. This is a very similar approach used by others and myself within Navigant to identify the net present value of acquisition alternatives being considered by our clients. In such cases the inputs that we will include in such an analysis are fixed and variable operating expenses, forecasted energy prices, expected/required return, and the debt/equity structure of the contemplated deal.

Q. Is there any disadvantage to not having used a production cost model for screening purposes and for identifying the least cost alternative among the offers submitted in response to the RFP?

A. For comparative purposes, the use of a production cost model instead of the models used by PacifiCorp would not have yielded a substantively different ranking of offers. However, when PacifiCorp gets to the point of having to seek cost recovery for the ongoing operating costs it will incur at the Currant Creek facility, I would recommend the use of a production cost model to more accurately identify the costs that will be incurred to operate and maintain the facility as an integrated piece of PacifiCorp's resource portfolio.

Q. How do you respond to the critique that it was inappropriate for PacifiCorp to have two separate models that it used to evaluate offers?

A. Although they were two distinct models, they were not different in their fundamental calculations, which were intended to identify the highest economic value associated with each proposed alternative over a comparable time frame. Since PacifiCorp expected and received primarily two different types of offers – PPAs and turnkeys – it was appropropriate for PacifiCorp to use two distinct models. From Navigant's perspective, the separation of offers into the two respective buckets was done in order to capture the nuances of each offer. Before PacifiCorp used either model, Navigant evaluated and validated the input, calculation, and output components of each model to validate that similar results would be derived whether you used the cost-based model (which was intended to capture the value of turnkey offers) or market-based model (which was designed to facilitate the ready review of various types of PPA offers). Navigant tested each model using data for like proposals prior to any actual RFP bid data being input to ensure that expected results could be achieved with those models.

Q. Do you agree that it was inappropriate to use a 35-year plus period to analyze offers that were only 20 years in duration?

A. No. This classic method in corporate investment planning of comparing investments of unequal lives is appropriate and accepted in the industry. In order to facilitate a side-by-side comparison of two investments of unequal lives it is reasonable to take the net present value of each investment over their respective lives and derive an equivalent annualized value. This allows one to incorporate the value and costs that would be incurred in the latter years of the longer-lived investment. To ignore the costs and revenues in such a financial comparison would lead to an improper analysis and faulty conclusions. The comparable example that is often cited in financial textbooks is the valuation of bonds that have different maturities. In comparing a 7-year bond with a 10-year bond, you will take into account the total return you would expect to receive over the entire time you would hold that bond. This would include not only the price at which you would purchase the bond, but also the transaction fees, the interest rate, and the respective income you would receive until the bond matures. Following the logic proposed by Messrs. Falkenberg and Banasiewicz, you would ignore the last three years of value associated with the 10-year bond despite the fact that there would be value being left on the table. Their approach would lead you to make unsound financial choices every time you have alternatives with unequal lives.

Q. Is Mr. Wolverton accurate in his assertion that PacifiCorp precluded bidders from submitting or did not solicit offers longer than 20 years and that bidders did not understand how PacifiCorp would value a 20-year deal?

A. No. The PacifiCorp RFP clearly states that turnkey offers would be acceptable. It was fully expected and requested in the RFP that bidders could submit turnkey offers, offers that could have an expected life that extended beyond a 20-year period. Although the RFP stated an interest in proposals "up to 20 years," this was intended to refer to power purchase agreements not asset sales. Prudent financial analysis would suggest that you value an offer over its expected life whether that is a 10 or 20 year PPA or a combined-cycle turnkey project with a 35-year expected life. The fact that a bidder decides to recover all of its capital costs and a healthy return on its assets during the first 20 years of a 35-year asset, while also retaining the last 15 years for their own economic benefit is not PacifiCorp's fault. It fails logic that if PacifiCorp had sought a 10-year PPA that bidders would have been forced to recover all of their capital costs in the first 10 years. If the asset has remaining economic life, it is the bidder's responsibility to price the terms of their offer in such a way as to reflect the value they are willing to pass along to the buyer and what they want to retain for their own economic use. Dr. Powell in his testimony recognizes the discretion that parties like Spring Canyon have in pricing an offer over 20 years.

Q. Is the use of a 20-year term for the high end of a PPA consistent with industry experience?

A. Yes. Through a quick news search on the internet and a review of selected RFP documents, recent experience suggests that 20 years is not out of the ordinary as the upper limit on PPAs. Just looking at the example RFPs cited in publicly available documents, 8 out of the 20 Navigant found identified 20 years as the maximum term that they were interested in. While a couple of companies were willing to look over 25 years in their solicitation of bids, these were in the minority. Exhibit UP&L ____ (HLF-2R) provides a table of this information.

Q. Do you agree with Mr. Banasiewicz regarding his concern that bidders would interpret the terms in the RFP to mean that a limited term of only 20 years was available?

A. No. Bidders in both bid categories that presented turnkey offers did so with the expectation that they were offering the plant for its entire economic life. The "up to 20 year" language was intended as a guide to bidders that this was the Company's preferred term for a contract. Nowhere in the RFP does it state that PacifiCorp would not consider options for extending the term beyond 20 years. If a bidder was interested in offering extensions, they should have included this in their proposal. Spring Canyon chose not to do this. Furthermore, the language in Spring Canyon's original proposal is silent on the issue of extending the terms of a power purchase agreement beyond a 20-year timeframe while making reference to a willingness to entertain purchase offers for the plant or an equity stake in the plant at the end of the term. Again the issue comes down to the fundamental pricing of a deal. If I had been advising a bidder on bidding into this RFP, I would have ensured that the pricing chosen for a 20-year PPA reflected the residual value that the bidder would be able to capture over the remaining economic life of the plant or had made sure that the rights they were willing to pass on to the buyer for a purchase option or extension were available for the buyer to assess.

Q. Is Mr. Wolverton correct in his belief that "PacifiCorp's projections and modeling methodologies would dictate that a contract with a term less than the expected life of a self-build resource will always appear less economic?"

A. No. The fundamental issue in question when a bidder prices an offer is what to retain for their own benefit and what to provide in value to the buyer, while trying to present the most economically competitive offer that it can. All bidders were aware that they would be compared against a self-build option from PacifiCorp that would have an associated economic life. Although they did not know what that self-build option would consist of, they should have understood that whatever the option, it would have been evaluated on a net present value basis over its expected life. As an example, one of the top offers in the baseload bid category, a 20-year power purchase agreement, is economically superior to PacifiCorp's NBA in that bid category. This clearly demonstrates the fault in Mr. Wolverton's logic. This particular bidder appropriately priced their offer in a competitively economic fashion with the understanding that they would be able to retain the value of that plant at the end of the 20-year PPA. Somehow they are able to economically price their offer, while retaining the value in the outward years and still be superior to the NBA.

Q. Did the addition of limitations to the number of duct-fired operating hours after Round II valuations result in a material change to the relative ranking of offers to the NBA?

A. No. Initially, PacifiCorp modeled the NBA by assuming that it would dispatch on a 7 by 24 basis even though many of those hours would be below the facility's marginal cost of production. After the second round, PacifiCorp modified the modeling of the NBA to reflect the 3,500 hour limitation that would be in place on the number of duct-firing hours that the facility could dispatch annually. As noted in Navigant's Screening Report, this factor did not affect the modeling of the PPAs. While material, this change did not result in a material change to the rank order of the offers because the economics of the NBA actually improved with the limitation.

Q. Should PacifiCorp have limited its economic evaluation of offers to the levelization of just the capital costs of each alternative?

A. No. It may have been appropriate to follow this methodology in PacifiCorp's IRP. However, prudence demands that the process of clarifying the net present value revenue requirement for each offer relative to one another use the entire set of costs and market revenues that would be associated with each alternative. Restricting such an analysis to just the capital costs would have led to potentially erroneous conclusions in the RFP process.

Q. What is the basis for your assertion that restricting the real levelization analysis to only capital costs would have led to potentially erroneous conclusions?

A. It is best illustrated through an example. In the classic case of deciding between a coal plant and a gas plant there are two different sets of capital and operating expenses. Coal plants tend to have a higher initial capital cost, but lower operating costs over their lives due in large part to the lower costs of fuel. Gas plants tend to have a lower capital cost, but higher fuel costs along with greater price volatility over time regarding its operating costs. Preparing an economic analysis that ignores the operating costs and revenues over the life of the investment would only account for half of the picture and would not be sound financial analysis. Not a single transaction I have been involved with ignores operating costs and revenues to derive the economic value of an asset based solely on its capital costs.

Q. Is it appropriate for PacifiCorp to have restricted the use of its real levelized revenue requirement methodology to capital costs in the IRP while extending the levelization methodology to the analysis of both costs and revenues in the RFP?

A. Yes. The fundamental distinction between the analyses performed in the IRP and the RFP comes down to the use to which real levelization is being put in each forum. In the case of the IRP, which is a cost-based model, the focus is on the capital costs of each alternative since this is what is input into the production cost model used by PacifiCorp. In this model the type, size and capital cost of each resource is taken into account in determining the best resource to be added over the forecast period to meet the projected need. In the case of the RFP, which is a margin-based model, what is of interest is identifying the marginal value of producing the next megawatt hour. The RFP model's focus was on identifying which resource alternative would yield the greatest value to ratepayers taking into account both the cost and value associated with that resource. In this situation, both revenues and costs are important to consider because both have an impact on the overall value that ratepayers would get from that resource. Following the approach proposed by Mr. Wolverton in his testimony would completely ignore this value that should be captured by ratepayers.

IV. CONSISTENCY AND FAIRNESS OF BIDDER TREATMENT

Q. Some witnesses have contended that they were treated in an inconsistent manner and that their proposals were not given a fair consideration in the RFP process. Do you agree with this assertion?

A. No. As the Outside Evaluator, Navigant's focus was on ensuring that each bidder was given a reasonable and equal opportunity to present their offer to PacifiCorp. PacifiCorp, with Navigant's guidance, followed a systematic approach of logging offer details presented by bidders and completing a valuation of that offer. In cases where information was not complete, PacifiCorp directed Navigant to seek clarification directly from the bidder. Bidders typically responded to these requests by providing the outstanding information that would allow PacifiCorp to complete the valuation. After this initial screening was conducted in a manner that was consistent with the RFP, PacifiCorp and Navigant initiated clarifying discussions with the short listed bidders. To ensure consistency and documentation of the process during each step of discussions with bidders, Navigant recommended that PacifiCorp use a consolidated offer summary sheet (or template) for each short listed offer as the basis for the clarifying discussions. These summary sheets were used to capture the material components of each deal. Prior to beginning the first discussions with each bidder, this sheet was provided to the bidders for them to redline and return to PacifiCorp before the initial call. To begin the process of better understanding what the bidder intended by their short listed offer, PacifiCorp walked through the red-lined offer summary sheet with each bidder to make sure that PacifiCorp understood what was being presented.

During the course of conversation with PacifiCorp, each bidder also had an opportunity to present variations of their original offer that they wanted PacifiCorp to consider subsequent to their initial offer being short listed. This is something that nearly all of the short-listed bidders in this bid category did. What this highlights is the fact that if anything of a material nature, such as start charges or option prices for purchasing a project at the end of a power purchase agreement, had not been included in PacifiCorp's summary of the offer, bidders had an opportunity to not only alter the summary sheet to make sure PacifiCorp included such material items in their valuation, but they also had a verbal opportunity to present alternative structures or corrections to material aspects of their proposed deals which they were expected to document via the bid sheets. I am hard pressed to see how PacifiCorp could have been more fair and consistent with the bidders beyond having coached each one of them as to how they could optimize the value of their offer by considering changes or additions to their offer that they had not thought to consider including themselves.

Q. Mr. Wolverton recommends "a reopening of the bidding process to allow bidders to make offers in response to PacifiCorp's Next Best Alternative." Is this appropriate in light of the consistent and thorough process used by PacifiCorp to screen and evaluate offers?

A. No. PacifiCorp used a formal solicitation process that was reviewed and approved by stakeholders and regulators prior to its implementation. PacifiCorp also complied with the June 6, 2003, stipulation between the Company and the signatory parties to use an independent Outside Evaluator to oversee the entire RFP process to ensure that PacifiCorp's approach to evaluating offers was fair, consistent and reasonable. Navigant prepared two interim reports as our first-hand documentation of the involvement we had in validating the cost assumptions underlying the NBAs, the reasonableness of the modeling tools that would be used to screen and benchmark offers against the NBAs, and the consistency with which PacifiCorp applied the screening criteria to the offers received. As a last installment for documenting the fair and reasonable process used by PacifiCorp to complete each facet of the RFP, Navigant has prepared its final report, attached hereto as Confidential Exhibit UP&L ____(HLF-3R), which identifies in detail the numerous steps taken by the Company to ensure that each bidder was given a fair and equal opportunity to present the terms associated with its offer. After all this, it was still found that the most economic offer for this bid category was the NBA.

Q. Do you agree with Mr. Banasiewicz that "the RFP process did not effectively evaluate Spring Canyon's ability to successfully complete the proposed project?"

A. No. As noted in the previous response, an explicitly outlined set of criteria were reviewed and approved by stakeholders for use in screening offers in the RFP. Other price and non-price factors would be evaluated during negotiations. Such factors are being given explicit treatment in the negotiations with parties in the baseload bid category. Since none of the offers in the peaker bid category were within a reasonable economic range of the NBA, it did not warrant moving to this next stage of discussions with these bidders. If they had progressed, weight would have been given to the progress the Company had made to date in developing its facility.

Q. Mr. Banasiewicz claims that PacifiCorp could not come to "any reasoned conclusion regarding Spring Canyon's ability to perform." Do you agree with this conclusion?

A. No. Although he correctly points out that PacifiCorp only asked cursory questions of its team members regarding their background and capability, PacifiCorp and Navigant were more interested in understanding the material aspects of the offer being presented by Spring Canyon than with the background and experience of its personnel. PacifiCorp was interested in understanding the role that each team member would play in the transaction, so this was the focus of the questioning that was done. From the perspective of the Outside Evaluator, this is yet another example of Spring Canyon trying to jump the gun to negotiations before ever completing a straightforward and clean statement of what it is they were ultimately offering to PacifiCorp.

Q. Is Spring Canyon accurate in its assertion that PacifiCorp failed to negotiate with Spring Canyon in a good faith manner?

A. No. Spring Canyon seemed to think that it was appropriate to withhold material components of its offer (e.g., cost of a purchase option, start charges and penalties, firmness of the capacity charge) until the period of post-bid negotiation. The fundamental problem is that the clarifying discussions PacifiCorp held with Spring Canyon never evolved to the point of negotiations because Spring Canyon's offer was simply uneconomic. In each session PacifiCorp held with Spring Canyon in 2003 on August 27th, September 10th, and then on October 16th, Spring Canyon seemed not to understand that PacifiCorp had to complete a reasonable level of due diligence before proceeding to negotiations. Just because Spring Canyon was short-listed in no way meant that PacifiCorp was going to commence negotiations with them without a firm understanding of their offer. PacifiCorp even stated this fact on page 11 of its RFP, which reads "those highest scoring proposals will be selected for further consideration ***and then*** for post-bid negotiations."

Q. Was the inability of Spring Canyon to commit to definitive terms one of the reasons why PacifiCorp was unable to progress to the stage of post-bid negotiations with Spring Canyon?

A. Yes, but this was only one of the factors. The most relevant variable was the poor economics of the deal proposed. Neither of their offers, Bid 135 or Bid 653, were economically competitive with the NBA. As Mr. Banasiewicz notes, PacifiCorp limited its discussion with Spring Canyon to continually asking "is this your best offer". This was a perennial theme because Spring Canyon, up until the last minute, kept indicating that it might be able to provide more attractive pricing for its deal, but in the end could not commit because they had insufficient time to conduct whatever internal analysis was necessary to reprice their offer. What this tells me is that Spring Canyon was ill-prepared going into the discussions with PacifiCorp and had not thought through many of the tougher issues relevant for understanding the capabilities and limitations of their proposed deal that were essential for deriving a baseline value of the deal over its life.

Q. Is it PacifiCorp's fault that Spring Canyon felt like it had insufficient time to prepare its offer?

A. No. Just like all of the other short listed bidders in this bid category, PacifiCorp and Navigant expected that bidders had given the necessary consideration to stand behind their deal and represent that it was the best deal they could offer. Spring Canyon was the only party on the short list that was unwilling to present a completely firm deal that they would be willing to move forward in negotiations with. Since Spring Canyon was unable to firm up its offer within the same time frame as other short listed bidders in the same bid category, PacifiCorp ended up giving all short listed bidders an extra 3 days to complete their final offers. In spite of the extra time, Spring Canyon did not provide firm terms.

Q. Mr. Banasiewicz claims that it is important that Spring Canyon was "willing to negotiate the sale of the facility at any time." Do you agree with his assertion regarding the importance of this intention?

A. No. Mr. Banasiewicz fails to understand the fundamental distinction between submitting something concrete and the intention of doing so. After repeated attempts to get firm information, not to mention the numerous opportunities that Spring Canyon had to communicate this intention in writing subsequent to their bid submittal, they chose not to do so because they felt this was more relevant for the period of negotiations. It was made clear to Mr. Banasiewicz and his team that Spring Canyon needed to share with PacifiCorp all of the material aspects of their proposed deal so PacifiCorp could complete its valuation. Their choice to leave out such a material component of their deal during clarifying discussions is inexcusable. To wait until a discovery meeting on December 10, 2003, to share such information was inappropriate.

Q. As the Outside Evaluator, did you find Spring Canyon to be open and forthright with information that would allow PacifiCorp to complete its due diligence?

A. No. For some reason, Spring Canyon felt it appropriate to withhold highly material pieces of their offer until a period of time when they would be negotiating with PacifiCorp. I found this to be highly unusual and inconsistent with the manner in which the majority of other short listed bidders acted. Spring Canyon left out the $1 purchase option at the end of the 20-year PPA from its written proposal and its two redline updates to the offer summary sheets, and also neglected to bring up even an indicative price in the clarifying discussions that it had with PacifiCorp, all of which I attended either in person or by phone.

Q. Were there any other fundamental issues that PacifiCorp was unable to obtain clarity on with Spring Canyon during its due diligence that would have allowed PacifiCorp to move forward with any type of negotiations with Spring Canyon?

A. Yes. There was the issue of the capacity charge being non-firm due to Spring Canyon needing to lock-in its financing first. Although they identified an interest rate for their debt financing of 8.25%, they indicated that the monthly capacity charge was not a firm component of their offer and would not be made firm until financing was complete. Although they indicated that they would pass along a lower capacity charge in the case of more attractive financing, they also stated that the capacity charge would go up if the financing they secured offered less attractive terms. Out of the 37 companies that submitted proposals across the three bid categories in the RFP, Spring Canyon was the only one that had a contingent-pricing component embedded in their offer.

Q. Did PacifiCorp act in a bad-faith manner during its discussions with Spring Canyon as Mr. Graeber asserts?

A. No. In fact, PacifiCorp approached the clarifying discussions with Spring Canyon in the same manner as they did with other bidders—focusing on making sure that they had accurately captured the material terms of the offer presented by the bidder and confirming that the terms presented were the best that they could do based on preliminary feedback from PacifiCorp. Spring Canyon, unlike other bidders, seemed to have difficulty providing firm information for PacifiCorp to complete its evaluation. Only after repeated attempts at getting Spring Canyon to commit to the terms of its offer was PacifiCorp able to complete its valuation and even then, it was done by making assumptions regarding the ultimate costs of the Spring Canyon offer due to the uncertainty regarding financing, the EPC contract, and the availability penalties. Although stated in the RFP that PacifiCorp wanted to better understand the offers before moving to negotiation, Spring Canyon appeared interested in bypassing this step and moving straight to negotiations after being short-listed.

Q. Aren't you just splitting hairs by making a distinction between clarifying discussions and negotiations?

A. No. A critical step in any transaction, whether it is entering a long-term power purchase agreement or purchasing a turnkey facility, is validating what it is you are really getting. This is common industry practice to go through an initial period of due diligence and it is a prudent activity whether entering into a long-term commitment or buying a power plant or any other investment requiring a substantial capital commitment.

Q. Was the issue of "term" relevant in establishing consistency between the NBA and the information requested of bidders through the RFP?

A. No. The term of each deal was only relevant in so far as it was an input for valuing the deal. The more important issue is how one chose to price their deal over whatever term they chose. There did not have to be consistency in the exact term proposed by a bidder and what the term of the NBA was. PacifiCorp fully expected that bidders would submit turnkey assets, PPAs from new facilities, PPAs from existing plants and facility leases with a wide variety of terms.

Q. Spring Canyon and Mr. Falkenberg mention the fact that Bid 653 was not treated in the same manner as Bid 135 even though it was submitted for consideration by the same bidder and had the same operating limitations. Did this exemplify a fatal flaw in the RFP process?

A. To respond to this question, it is important to put both bids in the context of the RFP process and the steps that were taken by PacifiCorp to objectively review each offer. As outlined in the RFP, bidders were asked to submit offers on a ***blinded*** basis and indicate which bid category to which they were responding. As blinded proposals, PacifiCorp was not in a position to connect the dots between the more than 100 proposals that it received and figure out which bidder submitted which proposals. That was the whole intent behind the blinding process. Although both proposals read with similar language, it ended up that two different analysts within PacifiCorp had been responsible for modeling the respective offers. Bid 653 has conflicting proposal details regarding the operating capability. In one place it says unlimited starts and in another later section it is stated that there is a 260-start limit. As a result of this limitation, the comparative economics of Bid 653 would have been better served by being compared against the baseload NBA. Bid 135 should also have been moved out of the peaker category in light of this limitation, but was not because its economics allowed it to compare favorably enough with the NBA until the start limitation could be clarified. At this point, PacifiCorp did not know the respective bidder behind each of these two proposals. It was only after the short listing and deblinding of the short listed offers that PacifiCorp knew Spring Canyon was one of the short listed bidders, but this was not the case for Bid 653 because it did not make the short list in the other bid category.

Prior to beginning clarifying discussions, as noted elsewhere in my testimony, a term sheet was sent to each short listed bidder for their redlining. The offer summary sent back to PacifiCorp by Mr. Graeber stated that their offer allowed up to 260 starts per year. During the course of the initial clarifying discussions with Spring Canyon regarding Bid 135, they highlighted the fact that their offer really did have unlimited starts, but that their indicative pricing was based on the assumption that it would only be started 260 times a year. PacifiCorp stated their interest in not having the 260 starts/year limitation so Spring Canyon revised their pricing and included a start charge to reflect their perceived cost of offering this capability to PacifiCorp. As discussions evolved with Spring Canyon, they asked about their bid that included duct firing. Since it had not made a short list, PacifiCorp did not know that it was theirs. The way Spring Canyon priced that offer, with the capacity charges applying to both the CCCT capacity and the duct firing, made this offer uneconomic, in addition to other issues such as their pricing package for their 20-year PPA.

V. RELEVANCE OF NEW MATERIAL BID INFORMATION

Q. Were there any bidders that attempted to introduce new material bid information subsequent to the conclusion of the peaker bid category RFP process?

A. Yes. Through Mr. Banasiewicz' testimony, Spring Canyon is attempting to introduce new material bid information that they feel should be given consideration by the Commission and PacifiCorp.

Q. Does the proposal of new material bid information in the Spring Canyon testimony in the course of this formal proceeding compromise the integrity of the RFP process?

A. Yes. As described above, each bidder that made the short list had more than one opportunity to present variations of their offer that they would like PacifiCorp to consider. For a bidder like Spring Canyon to come forth with new material information during the process of discovery and now in their testimony is not only unorthodox, but it is also inappropriate.

Q. Why is it inappropriate to consider this new material information from Spring Canyon regarding their offer?

A. Each short-listed bidder was given several opportunities to present alternative deal structures and clarify the exact terms of their offer during the preliminary short list discussions. Notwithstanding the fact that modeling their offer with the terms they have proposed in this proceeding does not result in their offer being least cost (as discussed in detail in the rebuttal testimony of Mr. Klein), to now accept what Spring Canyon has offered would raise the ire of the other short-listed bidders in this bid category, particularly the bidder that had a more economically superior offer to the Spring Canyon offer. To afford this special treatment of Spring Canyon's offer undermines the diligence applied by both PacifiCorp and Navigant to ensure that bidders received equal and consistent treatment.

Q. How do you respond to Mr. Banasiewicz and Mr. Graeber's assertions that they were forced to recover their costs over 20 years rather than a 35-year period?

A. Since they offered a power purchase agreement for 20 years with no indicative or definitive option value at the end of the term, PacifiCorp rightfully interpreted that Spring Canyon would be retaining the value of their plant after the 20 year period was over. PacifiCorp had no insight into how Spring Canyon was going to recover its costs, service its debt and earn a return. Following Spring Canyon's logic, it appears that if PacifiCorp had issued an RFP that requested offers up to 10 years that they would have to recover all of their costs in a 10-year period of time, despite the fact that even in this scenario they are retaining the value of an asset that has an expected life well beyond the term requested.

Q. Is Mr. Falkenberg correct in his assertion that "bidders who complied with the 20-year term had virtually no chance of winning the bid?"

A. No. This conclusion is wrong in several respects. First, he assumes that whatever asset a bidder proposed in the RFP has no value beyond the 20-year period, which in the case of Spring Canyon and Duke's offers, the top two competitive offers in this bid category, was incorrect in light of the combined-cycle technology that was proposed in each offer. Second, he presumes that bidders are incapable of competitively pricing their offers taking into account any retained value that they do not intend to pass along to the buyer. Third, two bidders in the baseload bid category that proposed PPAs for 20 years were found to be economically superior to the NBA in that bid category based on the indicative information submitted by the bidders.

Q. In addition to the purchase option that Spring Canyon asserts was discussed with PacifiCorp, they have also stated that they offered a $18,700 start charge with a $10,000 penalty if start-up had not occurred as requested by PacifiCorp. Is there anything you find troubling about this new revelation?

A. Yes. Notwithstanding the fact that this demonstrates the continuing difficulties we had with Spring Canyon in having them articulate what it was that was really being offered, they have here again introduced new material information in this proceeding when it should have been explained to both PacifiCorp and Navigant during the clarifying discussions held in September and October. Even after repeated attempts to obtain clarification on Spring Canyon's bonus/penalty concept, it remains unclear. This is not the appropriate forum to be attempting to introduce new material information, which PacifiCorp has not had an opportunity to validate and understand.

VI. ENHANCEMENTS SUGGESTED FOR PACIFICORP'S SOLICITATIONS

Q. Several witnesses offered specific enhancements that should be made to either this and/or future solicitations. Do you think these recommendations have any merit?

A. While I am a firm believer in the process of continuous improvement and have made some suggestions for improvements that PacifiCorp should consider in future solicitations, taking the recommendations made by several of the witnesses might create other practical problems. Therefore, I would like to address each suggestion on its individual merits.

Q. Do you agree with Ms. Murray's recommendation that the bidders should be told what the book life for evaluation should be prior to submitting proposals?

A. Not entirely. This suggestion might be appropriate in a situation where PacifiCorp is being prescriptive and requesting one type of proposal, such as a turnkey project. In a situation where PacifiCorp is considering purchase alternatives, leases, and PPAs to meet the same need, it is not practical to tell bidders that they will all be subject to the same book life. As an example, a 20-year PPA should be treated as a 20-year option while a turnkey combined cycled facility offered to PacifiCorp should have a book value consistent with its expected life of 35 years. It is not an accepted financial practice to artificially ascribe the same book value to investments of different lives.

Q. Ms. Murray makes a second recommendation that bidders should be allowed to self-screen their proposals in the first round. Do you agree with this recommendation?

A. No. From my perspective as the outside evaluator, it is very important to preserve consistency in the valuation and screening of all offers. Allowing bidders to take the models and screen their own offers against the Company's benchmark would not result in either a more efficient process or more cost effective offers. It would not save any steps in the process of identifying the most cost-effective resource alternatives and would lead to a classic case of gaming inputs to ensure that offer(s) came in just below the benchmark.

Q. Do you agree with Ms. Murray that PacifiCorp insufficiently clarified what was required of the bidders concerning variable O&M and start-up costs?

A. No. In its RFP, PacifiCorp requested of bidders that they provide the pricing for their offer that was consistent with how they would expect to be compensated for the availability and dispatch of their facility. PacifiCorp identified in the RFP the requirement for daily dispatch flexibility, so bidders should have assumed a dispatch that reflected this request, which most did. Since the hours of operation would be determined by the heat rate and marginal cost of dispatch, it is not realistic to impose a definitive number of hours that the facility would be dispatched. However, PacifiCorp did identify the specific sets of hours that it would prefer to see a facility being available for dispatch. Most importantly, it is the discretion of the bidder to decide the manner in which they will recover their costs and a return on their investment. While PacifiCorp will be expected to identify the explicit cost basis for the individual components of their self-build alternative within certain constraints, bidders have an ability to shift their costs to whatever categories they determine are most appropriate while trying not to price themselves out of contention.

Q. Is Ms. Murray's contention that the RFP should be transparent in all specifications for bids a reasonable request?

A. Yes. I would agree that an RFP should be transparent in all facets to ensure that bidders have a clear understanding of what is being requested and would be preferred by the company issuing the solicitation. By the same token, if PacifiCorp is interested in considering a breadth of alternatives they would have to balance this with being too restrictive by imposing specific criteria that would be disadvantageous to some alternatives. In future RFPs where an NBA is used, I would agree with Ms. Murray that bidders should be informed about some of the details of the facility against which they will be benchmarked. This was done in the RFP by informing bidders that they were being compared against a cost-based alternative.

Q. Do you believe that the lack of this information by bidders was a fatal flaw in the RFP Process?

A. No. Bidders were provided with sufficient background as to what PacifiCorp was seeking in this bid category. As was communicated in the June 20, 2003 Pre-Bid Workshop materials and discussion, the minimum bid criteria were the on-line date of June 2005 and sufficient flexibility in the facility to allow a daily dispatch. Knowledge of the exact type of benchmark facility may have discouraged some bidders from submitting bids, but it is highly unlikely that PacifiCorp would have received alternative proposal configurations than those received. In fact, a few bidders submitted proposals in this bid category that were of a similar configuration to that proposed by PacifiCorp.

Q. Do you agree with Ms. Murray and Mr. Falkenberg's recommendation that a production cost model should have been the exclusive tool used to value the offers submitted in response to the RFP?

A. No. While Mr. Klein will be addressing the fundamental analytical differences and limitations of production cost models, I wanted to comment on the practical difficulties of relying on production cost models to facilitate a timely review of offers. Since PacifiCorp received nearly 100 different offers that it was able to model, the use of a production cost model to value each offer, which can take up to 14 hours each, would have resulted in nearly 1,400 hours. Even if the Company were to have split the computing activities among 6 different computers, it would have still taken 23 10-hour days to complete an initial evaluation of each offer under just one dispatch scenario using the production cost model tools suggested by Ms. Murray and Mr. Falkenberg. This does not even include the revised runs that would have been undertaken as a result of Navigant's review and validation of the assumptions and results that would have added several more days to the review. It also does not include the additional runs that PacifiCorp would have made to identify the most economically attractive dispatch profile for each offer given its respective heat rate and marginal costs. I would also caution the use of two separate modeling methodologies for use in evaluating RFP offers due to the possibility of having to justify any resulting change in ranking.

Q. Has it been Navigant's experience that production cost models offer the only and most expeditious means of valuing supply alternatives as Mr. Falkenberg suggests?

A. No. It has been Navigant's experience that production cost models such as Midas, Aurora, GE Maps, and ProSym, while valuable tools for looking at the overall costs and value of integrating a resource into a company's portfolio, are cumbersome tools for use in screening offers that might be considered economic alternatives for a company to consider more in depth. Many economic valuation models have been developed by our clients as well as internally within Navigant for use in determining the comparative valuation of investment alternatives that facilitate an efficient and fair comparison of alternatives across a range of economic and operational conditions. Production cost models can have their place in the review process, but they are not an essential tool for narrowing a list of offers down to a manageable list of bidders with whom to negotiate.

Q. Do you agree with Ms. Murray's recommendation that the RFP process should define exactly what the negotiation process would entail?

A. Yes. This is what PacifiCorp did in its RFP, which states that both price and non-price terms would be negotiated. The Company even bolded this fact in the actual RFP to ensure that bidders were aware of what would be included in the negotiation period. The issue that she alludes to is apparently the concern raised by Spring Canyon that PacifiCorp never negotiated with them in good faith regarding these terms. The fundamental distinction to be drawn is that Spring Canyon never presented a firm indicative offer to PacifiCorp that was worth taking to the next stage of negotiation. This is the only short-listed party within this bid category that had such difficulty presenting a definitive offer along with any hybrids of its basic offer that it wanted PacifiCorp to consider. I am still confounded by this fact based on the stated years of experience that the Spring Canyon team has in the industry.

Q. Is Ms. Murray's recommendation that PacifiCorp clearly identify non-price requirements in the RFP reasonable?

A. Yes. Having gone through an extensive stakeholder and regulatory review, my understanding is that the RFP reflected the explicit criteria that were requested by parties that reviewed the RFP. If one looks at the RFP itself, they would see that it clearly identifies the non-price criteria that would be used for screening – dispatchability and environmental characteristics. I would be in favor of including other such non-price criteria as progress toward development and the firmness of prices, as suggested by Ms. Murray, as well as credit quality and the demonstrated development experience of the proposed counterparty. I can represent from direct experience and other projects in which Navigant has been involved over the past three years that such criteria have been included in most other RFPs.

Q. Does this conclude your testimony?

A. Yes.