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. 04-035-30
Construction of the Lake Side	)	
Power Project	)	

REBUTTAL TESTIMONY OF MARK R. TALLMAN

October 15, 2004

Q. Please state your name.

A. My name is Mark R. Tallman.

Q. Did you previously offer testimony in this proceeding?

A. Yes, I filed testimony in the Company's direct case.

Purpose and Summary of Testimony

Q. What is the purpose of your testimony?

A. I will address a variety of misperceptions held by the Utah Association of Energy Users Intervention Group (UAE) and provide clarifying context regarding statements contained in the testimony of the Division of Public Utilities (Division) regarding the Request for Proposal (RFP) 2003A process.

Q. How is your testimony organized?

A. My testimony is organized into seven sections. I first address statements by UAE regarding the fairness and timing of the RFP process (Section I). Next, I correct UAE's misinformation with respect to the need for capacity (Section II), certain CO2 related analyses (Section III), real levelization as a valid analytical technique (Section IV), and its conclusion regarding the comparison between the NBA and various projects (Section V). I address Mr. Weir's comments regarding fuel choice in Section VI. Finally, I provide clarification regarding statements in the Division's testimony (Section VII).

I. The RFP 2003A Process Was Fair and Reasonable

Q. Mr. Weir of UAE testifies that he cannot accept that the RFP process used to select Summit Power was fair or reasonable. Do you agree?

A. No. Navigant Consulting has unequivocally testified as to how the process was run fairly. In addition, the Division's consultant (Merrimack Energy) has "found no evidence to refute Navigant's conclusions".

Q. Mr. Weir references Navigant's view that the RFP Process "took longer than expected". What does Mr. Weir's testimony fail to mention?

A. Mr. Weir references a portion of Mr. Friedman's direct testimony [page 16, line 23 – page 17, line 1] but fails to mention Navigant's opinion with respect to the delay.

Q. What is Navigant's opinion with respect to the process delay?

A. Mr. Friedman of Navigant testifies that:

> *"Although the process took longer than expected, it resulted in the Company being able to diligently address all of the costs and risks associated with each of the offers that it negotiated in parallel with the selected counterparties."*

Q. Mr. Weir alleges that PacifiCorp is in control of all significant timing decisions in pursuit of new resources and can manipulate this timing to ensure a desired outcome in the resource procurement process. Do you agree?

A. No. Quite frankly I am surprised that Mr. Weir comes to this conclusion. PacifiCorp has made it clear that it intends to develop detailed integrated resource plans that involve the participation of all key stakeholders. The process of getting input and buy-in from all key parties is a time-consuming process, which PacifiCorp believes results in more robust planning decisions for the benefit of all its customers. UAE is well aware that PacifiCorp operates in a multi-state planning environment and is also aware that the process of acknowledgment of an integrated resource plan (IRP) plan can be delayed as a direct result of the request from stakeholders or Commissions for more time to review the proposals and assumptions contained in the IRP. Indeed, UAE is well aware of this as it was one of a number of Utah parties that sought and received a delay in the last IRP process.

Q. Have there been any other reasons that the process has been delayed?

A. Yes. The RFP process was based on items contained in the Action Plan in the IRP. In issuing the RFP PacifiCorp went through a number of processes to get parties comfortable with the proposed RFP process. This included a Commission review process in Oregon and the development of a stipulation in Utah. Again, UAE was a participant involved in the time consuming development of that stipulation. I am therefore surprised that Mr. Weir contends that PacifiCorp is in control of all significant timing decisions.

Q. How do you respond to the allegations of Mr. Weir regarding the timing of the resource selection process?

A. The focus of the planning process and the resource procurement process is to obtain the best cost/risk balance for customers. While the RFP process has taken more time than PacifiCorp would have wished, the simple fact of the matter is that these processes are complex matters that take time to bring to conclusion. In this specific RFP, the negotiations with Bidder 213 required more time than was originally planned but, despite this, Mr. Selgrade (a consultant for the Division) recognizes "significantly more time would have been required to settle the number of material open issues with respect to Bidder 213." It should also be noted that these negotiations also allowed time for due diligence to be performed on another short-listed bidder, resulting in their elimination from the process, and for negotiations to begin with another bidder.

Q. Would you agree with Mr. Weir that the timing for Lakeside has been manipulated to ensure a desired outcome?

A. No, I have to fundamentally disagree with Mr. Weir's characterization of the process. Not only did this process allow for an adequate amount of time, despite negotiations running late, but it also allowed up to six months for obtaining a certificate of convenience and necessity (CCN). As UAE knows, consensus was reached in RFP Technical Workshops that six months is an appropriate amount of time to conduct a CCN process under most circumstances. If I follow Mr. Weir's apparent logic, the Company would need to allow time to negotiate in good faith, reach the best deal for customers, execute a complex commercial agreement, allow six months for a CCN proceeding, and then double this time again in case the entire process has to start over. This is simply not realistic. Exhibit UP&L ___ (MRT-1R) shows how long the current process has taken from the development of the IRP through the issuing and execution of the RFP. I believe that the exhibit speaks for itself. This is not a process that is being manipulated to bring forth resources that can then be forced on customers. Rather, it is a process that seeks stakeholder input to ensure that the best benefit for customers is realized.

Q. Was the Company in complete control of the negotiation process and the amount of time it took?

A. No. The transactions being considered were complex. The Bidder 213 proposed transaction was more complex than the Summit Power transaction and necessitated the negotiation and consideration of various structures.

Q. Why was the Bidder 213 transaction more complex?

A. The Bidder 213 transaction was in two distinct steps: (1) development/construction followed by, (2) long-term tolling services. The Summit Power transaction was for development/construction only. A primary complication for both phases of the Bidder 213 transaction arose from credit-related issues.

Q. Did the Company engage in good faith negotiations with both Summit Power and the bidder for Bid 213?

A. Yes. This was witnessed by Navigant and acknowledged by Division witness Mr. Selgrade who states:

> *"The record does not indicate any lack of effort on their part; to the contrary, their respective efforts appear serious and unimpeded by client reservations. To the extent the negotiations are documented in the record, serious business differences are the likely reason for the amount of time taken in the negotiations."*

II. The Need for Capacity is Real

Q. Mr. Weir notes that the Company has found contracts for 390 MW of new generation for 2005 and that these purchases could have displaced the need for the Currant Creek plant. Is this the case?

A. No, this is not the case. It is true that the Company has been able to enter into transactions for delivery in 2005 as well as in 2006 and 2007. It is not true that these transactions would have displaced the need for Currant Creek in 2005 or during the life of the project.

Q. Is there any evidence that supports Mr. Weir's statement regarding the ability of market resources to displace the need for Currant Creek in 2005?

A. No. As I testified in the Currant Creek proceeding, and as the Commission found, there was a genuine need for additional resources in the summer of 2005 and Currant Creek was a reasonable choice to fill a portion of that need. The Company is still short with the market resources referenced by Mr. Weir and with Currant Creek coming on line in 2005. Deferral of Currant Creek would only have exacerbated the short position.

III. CO2 Analysis

Q. Mr. Weir states that it is "not facially plausible" for one bid to be evaluated at $0.77 per kw-month versus a self-owned project being evaluated at $3.04 per kw-month "when the CO_2 risk was left (in both cases) with ratepayers". Would you please address Mr. Weir's concerns?

A. Simply put, the economic value of the Bidder 213 proposal dramatically decreases (from a customer perspective) in the event that Bidder 213 fails to meet its CO2 obligations. This is because the Bidder 213 proposal contains capacity charges that are not a function of any future CO2 tax. This means, in the event Bidder 213 cannot or will not fulfill its CO2 obligation, then customers would have paid, in addition to capacity charges, an additional CO2 premium for a service they don't receive. That is not true under the Summit Power proposal. Given the fact that the dollar value associated with Bidder 213's announced intent to accept, but not to fully collateralize, CO2 liability for some of the contract term was approximately $604 million, it is true that the Bidder 213 transaction would evaluate to be $0.77/kW-mo under those circumstances described above and the Summit proposal would remain at $3.04/kW-mo. The economic value of the Bidder 213 proposal is also obviously affected by the assumptions regarding the timing and amount of the CO_2 expense. For example, under the new IRP assumptions regarding CO_2 costs, the economic value of that bid is reduced.

IV. Real Levelization

Q. As in the Currant Creek proceeding, UAE, through Mr. Weir's testimony, is once again asserting that "PacifiCorp's real levelization technique" dramatically impacted the results of PacifiCorp's 2003-A RFP. Is Mr. Weir's assertion accurate?

A. No. The real levelization methodology utilized by the Company to compare bids in the 2003A RFP is not "PacifiCorp's real levelization technique", but rather an industry accepted method for comparing proposals with unequal lives. This method is promoted by the Tellus Institute's Energy Group[1]. Further, Boston Pacific (a consulting firm) validated the use of real levelization in a white paper that was presented by Calpine during a RFP Technical Workshop. Lastly, and more importantly, the real levelization technique did not impact the results of the 2003A RFP. The bids themselves impacted the results of the 2003A RFP, not the analysis methodology. The analysis methodology was applied equally to all bids, leaving only the bid specifics to impact the results of the 2003A RFP. In fact, the primary benefit of the real levelization technique is that it removes discretion from the evaluator's analysis, allowing each bid to stand on its own economics.

Q. You mentioned a Boston Pacific white paper, would you discuss that document in more detail?

A. During a RFP Technical Workshop, Boston Pacific, appearing at the request of Calpine, answered questions regarding a paper entitled "<u>Bid Evaluation Methods in Competitive</u>

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[1] The Tellus Institute provides analyses to energy and utility policymakers at consumer advocate offices, public utility commissions, and non-governmental organizations throughout North America.

Solicitations: A White Paper on Techniques Used to Evaluate Power Supply Proposals with Unequal Lives". I have included a copy of this paper as Exhibit UP&L___ (MRT-2R). Boston Pacific's white paper provides a description and quantification of five popular techniques utilized for comparing proposals with unequal lives. Out of these five techniques, Boston Pacific concludes that the "annuity method" should be utilized to compare bids with unequal lives, while also recommending the real levelization method.[2] The white paper serves as an additional validation to PacifiCorp's evaluation methodology.

Q. Did the white paper address any of the other issues raised by UAE in the Currant Creek proceeding related to real levelization?

A. Yes. The paper also addresses a point that was controversial in the Currant Creek proceeding. In that proceeding, a UAE witness attacked the concept of levelizing megawatts in order to perform a real levelization analysis. As noted on page 4 of the Boston Pacific paper, "*most importantly, the evaluator divides the inflation adjusted real annuity by the inflation adjusted real annuity MW*". While this methodology was criticized by UAE in the Currant Creek proceeding, yet supported by Boston Pacific, it should be noted that dividing a real annuity MW value into a real annuity dollar value is an easy straightforward method for determining the single capacity adjusted dollar annuity value which, when applied to the nominal MWs and present valued, will provide a present value exactly equal to the present value of the nominal dollar values. This is a fundamental underlying premise for real levelization and one that the Division points out in the direct testimony submitted by Mr. Oliver.

[2] As stated by Boston Pacific, "If performed correctly, the Real Levelized Revenue Requirement Method should produce results similar to the Annuity Method." In fact, the two methods should produce identical results.

Q. In addition to the real levelization technique, did the Company utilize another industry common technique for comparing bids?

A. Yes. In analyzing the bids in the RFP 2003A, the Company not only used the industry common real levelization technique discussed above but also another technique that is identical to the "annuity method" praised by Boston Pacific in their white paper. The annuity method is also logical, easy to use and, just as with real levelization, removes discretion from the evaluator's analysis. In the Company's RFP 2003A analysis, the annuity method produces results identical to those produced by the real levelization method.

V. NBA Comparison

Q. Mr. Weir represents that "there were 20 projects in this bid evaluation that were financially superior to the NBA – the expansion of Currant Creek." Is that statement accurate?

A. No. Even on an indicative basis, there were only two projects with economics better than the NBA and one project with economics comparable to the NBA.

VI. Fuel Risk

Q. Mr. Weir expresses concern about "excessive reliance by PacifiCorp on natural gas resources in this area." Would you address that issue?

A. First, I would reiterate that the issues of fuel diversity and fuel source receive considerable scrutiny in our planning processes and in our approach to managing fuel supply. We will continue to review and analyze those issues in the IRP process. Second, I find it interesting that Mr. Weir's concerns surface now for the 534 MW (summer rated) Lake Side Power Project while they have not been raised with respect to the 817 MW gas fired project proposed by Bidder 213. Indeed, UAE appears to be supportive of that larger project.

VII. Clarifying Context Regarding Statements in the Division's Testimony

Q. Mr. Oliver's testimony might cause one to perceive that the Company did not utilize a real levelization methodology. Do you believe that Mr. Oliver's testimony makes that point?

A. No. Informal discussions with Mr. Oliver and Dr. Powell indicate that the Company and the Division share the same view of what constitutes real levelization. The Company and Mr. Oliver only differ in terms of how to best represent the results of the technique. The Company prefers to express the results on a $/kW-month basis whereas Mr. Oliver prefers to express the results on a $/MWh basis. Either approach produces the same results.

Q. Mr. Selgrade for the Division comments that the Company "offered" construction financing to Bidder 493. Is this statement entirely correct?

A. The company did not "offer" construction financing to Bidder 493 in the traditional sense of volunteering to be Bidder 493's project finance lender. However, Mr. Selgrade accurately considers the progress payment based structure offered by Bidder 493 in the RFP process as effectively a financing mechanism. The Company took all appropriate steps in the documentation of the contracts with Bidder 493 including: Company ownership of the real property; first priority secured liens; pledges of the membership interests of both Summit special purpose entities; and lender-type consents with the engineer/procure/construct contractor. Likewise, the Company also recognized its effective risks in the Bidder 213 transaction and attempted to negotiate appropriate provisions. In neither instance did the Company offer to be a project finance lender.

Q. Please provide further background respecting Mr. Selgrade comments that PacifiCorp was responsible for gas procurement and delivery to the project site for both the Summit Power proposal and the proposal from Bidder 213.

A. It is true that PacifiCorp would have been responsible for procurement of natural gas under both proposals but the delivery point for each proposal was different. The delivery point for the Summit arrangement is the Project. The delivery point for the Bidder 213 transaction was not known to PacifiCorp as Bidder 213 desired to have the option to choose between Questar Pipeline #104 at Payson gate, Goshen, or on the Kern River Pipeline.

Q. Mr. Selgrade comments in footnote 29, page 29 of his testimony that "the bankruptcy of Bidder 213 after external financing would add marginally to the overall risk of delay, but would not justify adding 2 to 4 months to the projected construction duration." What did the Company consider in order to conclude that this delay was in fact appropriate to consider in its analysis?

A. It is very common in project finance transactions that site mobilization does not occur until a project lender has been found and committed to funding. This common practice would have reasonably led Mr. Selgrade to make the assumption he articulates on page 9, line 8 of his testimony that Bidder 213 would not finance construction from its internal funds. However, Bidder 213 told the Company on several occasions, in response to the Company's articulated concerns that it did not want to run the risk of delay while Bidder 213 sought project finance, that it would "balance sheet finance" the plant until it was as much as 80% complete. In fact, during the course of our negotiations, Bidder 213 walked us through how it had used this approach with a tolling party and project lender at a plant in Colorado that was financed at a date two months before commercial operation. Therefore, the risk of delay (analyzed by the Company at 2-4 months) that could occur prior to external financing being in place spanned the time period that included the bulk of project construction. This delay included the risk that Bidder 213 would default while the plant was part constructed or that PacifiCorp would face problems with lender-applied requirements that were added during a late date financing phase. Bidder 213 attempted to circumvent this issue by requesting that PacifiCorp sign a letter agreement that would have waived the Company's rights in advance of financing. Rather than waive these rights, PacifiCorp requested that the lender be brought into the negotiations, but Bidder 213 refused this request. Unable to resolve this issue, PacifiCorp believed that the only prudent course of action was to evaluate the risk of a bidder default pre-financing.

Q. Did the Company execute any transaction documents with Bidder 213?

A. Other than a non-reliance letter and three confidentiality agreements, the Company did not execute any transaction documents with Bidder 213. Hence, the guaranty referred to by Mr. Selgrade in page 7, footnote 3 of his testimony was "proposed," not "executed."

Q. Mr. Oliver for the Division comments that many of the bids were for gas-fired combustion cycle turbine projects (and thus had similar technology and dispatchability) and that price became the distinguishing characteristic during the screening phase which was not consistent with PacifiCorp's original scoring and evaluation process. Does the Company agree with that characterization?

A. Not entirely. Mr. Oliver is absolutely correct in that many of the bids were for projects based on similar technology. Mr. Oliver is also correct in that the screening methodology, after application of dispatchability and environmental screening criteria, reduces to a price comparison if units of like technology and dispatchability are compared. The Company does not believe that such an outcome is inconsistent with the process. It appears that Mr. Oliver is simply pointing out that the screening phase of the process was based on three factors; 1) environmental, 2) flexibility, and 3) price.

Q. Mr. Oliver describes recent issues or trends including the recent spate of credit downgrades for a number of power generators and the bankruptcy filings of a few. Mr. Oliver also comments that another trend is the use of an integrated system analysis for evaluating a portfolio of bids (where varying terms and project/contract types are present) is more the norm for assessing and evaluating the final portfolio of bids. Does the Company believe that the type of analysis described by Mr. Oliver was necessary in order to reach a valid decision for the RFP 2003A "2007" resource category?

A. No. Mr. Oliver points out that PacifiCorp's modeling approach is consistent and reasonable for comparing the pricing of like-proposals such as when both are considered to be "baseload" options with similar characteristics. Since the Summit Proposal and the Bidder 213 proposal both intended to use natural gas turbines produced by Siemens then it is reasonable to conclude that both should be considered to provide similar characteristics. Finally, Mr. Oliver himself concludes:

- "….the final decision rendered by PacifiCorp to negotiate a final contract with bid 493 is a reasonable solution" [Oliver Direct Testimony, page 29, lines 28-29], and

- “The Company’s decision to terminate negotiations and pursue negotiations and contract approval with the second bidder is reasonable and is consistent with sound utility practice” [Oliver Direct Testimony, page 31, lines 17-19].

Q. Do you feel that such an approach would have altered the outcome?

A. No. A portfolio evaluation approach consists of placing the highest ranking bids, with potentially different terms, into various portfolios. These portfolios are then run through an hourly model which simulates PacifiCorp’s system conditions. The portfolio with the lowest cost/risk balance would then be pursued commercially. I question the practical and commercial feasibility of such an approach where many bids are involved. In this instance, given that the Company did not receive any acceptable “super peak” category bids, there was a significantly superior “2005” category alternative, and we were evaluating shortlisted bids that consisted of such similar characteristics, it is the Company’s conclusion that the overall economics would not have improved if a portfolio evaluation process was utilized.

Q. Do you feel that a portfolio approach might be used in future RFPs?

A. Quite possibly. While I remain skeptical that we can effectively overcome some of the inherent practicalities to the satisfaction of all, I am confident that the work taking place on the Competitive Bidding Task Force will be useful as we reach consensus on this and other RFP process issues. Consensus will be important as the Company moves forward to implement the action plan published in the next IRP.

Q. Division Witness Andrea Coon comments on the potential fuel price risks that exist as the number of gas fired plants in the PacifiCorp fleet increases. Do you have any comments to make on this?

A. Yes. I understand Ms. Coon's comments relate to general possible future risks which are not specific to Lakeside. In discovery, Ms Coon clarifies that the Division is requesting that these possible future risks are examined in the future as part of the IRP process and/or other Commission proceedings.

Q. Do you agree with this recommendation?

A. Yes. The whole issue of fuel diversity and the risks associated with addition of both demand side and supply side alternatives are issues that face considerable scrutiny and attention in the IRP process. We intend to continue to look carefully at all the key factors that lead to the development of the best cost/risk balanced portfolio for our customers. The Division has been a key contributor to this process and we look forward to their continued valuable input.

Q. Ms. Coon also makes a statement about the fact that the Lakeside facility will decrease the amount of transmission of electricity that must be moved from outside the area to serve load. Do you have any clarification that you would make to this statement?

A. Yes. We agree with Ms. Coon that this would be the case for many hours of the year. We also agree with Ms Coon that with the continued anticipated growth of peak demand in Utah, the use of transmission import capability at peak load hours is not expected to decrease.

Q. Does this conclude your testimony?

A. Yes.