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ORIGINAL

MEMORANDUM

Public

To: Utah Public Service Commission

From: Division of Public Utilities  
Chris Parker, Director  
Energy Section  
Artie Powell, Manager  
Charles Peterson, Technical Consultant  
Thomas Brill, Technical Consultant

Date: November 23, 2011

Re: Docket No. 11-035-73, Rocky Mountain Power Request for Proposals

**RECOMMENDATIONS (Reject, Revise, and Resubmit)**

The Division of Public Utilities (Division, or DPU) recommends that the Public Service Commission (Commission) reject the Application of Rocky Mountain Power for Approval of a Solicitation Process, Docket No. 11-035-73. The Division makes a number of recommendations herein intended to improve the solicitation process. The Division recommends that the Commission suggest these recommendations to the Company, and other changes the Commission determines warranted, and invite the Company to resubmit its Application to the Commission for approval.

**ISSUE**

On October 5, 2011 the Company filed an application with the Commission requesting approval of a solicitation process for an all-source resource for 2016 (2016 RFP). A Scheduling

Conference on the approval of the solicitation process was held October 13. A Scheduling Order was issued October 19, 2011 and set November 18, 2011 as the date for submission of comments on the application for approval. This memorandum is the Division's response to the request for comments on the application for approval of the solicitation process.

## **BACKGROUND**

The Company's RFP process has evolved over the past few years as its power requirements have changed. The most recent RFP process sought resources for June 2014. On April 20, 2011, the Commission approved the Company's Significant Energy Resource Decision to acquire the Lake Side 2 natural gas-fired generating plant for service beginning June 2014.

In the current RFP the Company is seeking up to 600 MW of system resources as of June 1, 2016. The Division recognized the need for an additional 600 MW of CCCT eastside power in its recommendation for acknowledgement of the most recent IRP.

In considering the June 2016 RFP bids, the Company states that it will consider different resource alternatives proposed by bidders in one of three bid categories: base load, intermediate load, or summer peak Q3. Bidders may propose resource alternatives with the following guidelines: 1) base load bids have a capacity factor at or above 60 percent over the proposed term; 2) intermediate load bids have a capacity factor between 20 percent and 60 percent over the proposed term; and 3) summer peak Q3 bids will be purchased by the Company in summer months during specific hours of the day.

In addition to the three bid categories, the Company also requires bidders to propose one of the following resource alternatives: 1) Power Purchase Agreement (PPA); 2) Tolling Service Agreement (TSA); 3) Engineering Procurement Contract (EPC) on a Company-defined site and built to Company specifications; 4) Asset Purchase and Sale Agreement (APSA) on a bidder's site; 5) purchase of an existing facility; 6) purchase of a portion of a facility jointly owned or operated by the Company; 7) restructuring of an existing PPA or Exchange Agreement; or 8) exceptions (load curtailment, qualified facility, or eligible renewable resources).

The Company states that it is interested in creative bids and options as well as proposals that offer the Company flexibility in terms of the commencement date of delivery. Company interest in creative proposal options encourages bidders to offer different alternatives under the same proposal. Company flexibility with the delivery date allows it to defer or accelerate the in-service contract date or buy-out the contract. The Company's RFP process has evolved over the years as its interest has changed from base load power in earlier RFPs to increasing flexibility in most recent RFPs. In the current RFP process, the Company held a public meeting on September 1, 2011 in anticipation of release of the draft proposed RFP as well as a bidders' conference on October 20, 2011 after the release of the draft proposed RFP.

## **DISCUSSION**

1. No Benchmark. The Division is concerned that the Company is not proposing to submit a benchmark bid, unlike other recent RFP dockets. The Division believes that a benchmark bid by the Company, vetted by the Independent Evaluator, gives additional assurance to Utah regulators and interested parties that an RFP process results in the lowest-cost, least-risk resource. As it has demonstrated previously, the Company has in-house expertise to create a benchmark bid. Furthermore, the Company should cost out the bid using its access to its potentially advantageous low-cost financing. An obvious location for the Company's benchmark proposal would be its existing Currant Creek site that already has available space for another plant (Currant Creek II). The Company may use another site for its benchmark if it can propose a better location.

2. Indexing Bids. The Company should include the option to allow for limited inflationary adjustments in order to not potentially discourage some bidders. The fact that in the last RFP no bidder that made the initial short list used the cost adjustment option does not necessarily mean that a bidder wouldn't want to use a limited inflationary adjustment option this time. The Division understands that while inflation appears to be relatively benign at the moment, there are also clearly reasons that suggest this benign inflationary environment might not last.

In a prior RFP docket the Commission clearly supported the use of an indexing option. The Commission was responding to a recommendation of the Utah Independent Evaluator,

Merrimack Energy. This historical support in Utah for indexing is a further reason for the Company to reinstate the indexing component in the 2016 RFP.<sup>1</sup>

3. Bid Evaluation. The Company's 2016 RFP bid evaluation process appears to be overly simplistic: take the latest IRP Preferred Portfolio and create a "hole" for 2016, leaving everything else in the Preferred Portfolio fixed.<sup>2</sup> The "2016 hole" is created by removing from the preferred portfolio the approximately 600 MW CCCT gas plant located in the Company's East Side and then letting bidders attempt to fill this "2016 hole." Conceptually, if the IRP Preferred Portfolio is assumed to be the lowest-cost, least-risk solution to the Company's future needs, then the best way to fill the "2016 hole" is simply the plant the Company removed. Given that the Company is making available to bidders its site for another gas plant at its Currant Creek site (i.e. Currant Creek II), the 2016 RFP appears to be heavily weighted in favor of EPC bidders at that site. Given the structure of the Company's proposed 2016 RFP, especially the bid evaluation methodology, the Division is concerned that non-Currant Creek II bidders will be disadvantaged, making it difficult to determine if a winning bid from the 2016 RFP can confidently lead to the lowest-cost, least-risk resource.

4. Fixed Post-2016 Resources. Except for Front Office Transactions, the Company is proposing to fix post-2016 IRP resources as part of its bid evaluation methodology. The Division maintains, as it did in the Lake Side 2 proceeding (Docket No. 10-035-126), that fixing IRP resources in the outer years of the study does not allow bidder proposals to potentially defer those IRP resources and, thus, may understate the total potential present value of the proposal.

The Commission recognized in its Order in Docket No. 10-035-126, that the Division's recommendation to not fix any future IRP resources in evaluating the bids in future RFPs "had

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<sup>1</sup> Public Service Commission, "Commission's Suggested Modifications," Docket No. 05-035-47, December 21, 2006.

<sup>2</sup> In response to DPU DR 1.5b the Company suggested that bids requesting on-line dates prior to June 1, 2016, that were reviewed by the Independent Evaluators and accepted by the Company "could potentially defer front office transactions in the period prior to 2016 and would compete with all other proposals to meet the 2016 need without bias." In response to DPU DR 1.8 the Company stated that "Front office transactions will not be fixed to ensure that annual planning margins can be maintained."

merit” and would have avoided some of the trouble that arose in the Lake Side 2 approval docket.<sup>3</sup>

In Docket No. 10-035-126, the Lake Side 2 approval docket, and Docket No. 10-035-124, the Rocky Mountain Power general rate case, the Division brought up the issue of fixing IRP resources after the date an expected resource was due. The Division’s expert Consultant, Richard Hahn of La Capra Associates, Inc. presented testimony, supported by the Division in these dockets. Mr. Hahn also presented testimony supported by the Division, regarding the use of unmet energy costs in the modeling for resource selection. The following are a selection of the relevant statements by Mr. Hahn in the preceding dockets.

Post-2016 resource additions in the preferred portfolio were fixed in the bid evaluation process. This assumption prevents project bids in the RFP from displacing or deferring any generic resources included in the preferred portfolio after 2016, which could undervalue the bid projects being evaluated. Post-2016 generic resources should be options in the bid evaluation process, and the System Optimizer model should select the amount and timing of these units. This approach will allow RFP bid projects to displace post -2016 resources, and therefore more accurately assess the true value of Projects bid in the RFP. Analyses performed by the Company in the later stages of the evaluation imply that unmet energy costs should be excluded or considered separately. I disagree. Unmet energy costs, if based upon appropriate assumptions, should be included in the evaluation.<sup>4</sup>

**Q: Do you have any concerns with the manner in which capacity expansion in the dispatch modeling was used in phases 2, 3a and 3b of the evaluation process?**

A: Yes. In these steps of the evaluation, RMP fixed the quantity and timing of post-2016 planned capacity additions based on the preferred portfolio from its 2008 IRP Update.

**Q: Given that these resources were identified and included in the IRP, why is it not reasonable to include them in the RFP evaluation process?**

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<sup>3</sup> Public Service Commission, Report and Order. Docket No. 10-035-126, April 20, 2011, pages 20-21.

<sup>4</sup> Direct Testimony of Richard S. Hahn, Docket No. 10-035-126, March 3, 2011, at lines 155-165.

A: The goals of the two processes are different. While the IRP is intended to look at and answer broad questions regarding the direction of *potential* future portfolio procurement efforts, the RFP is evaluating specific resources related to specific, *actual* bids. Post-2016 planned resources in the IRP were established along with a specific set of 2012 to 2016 resources, including one new natural gas fired combined cycle unit in 2015. These 2012 to 2016 resources were removed from the preferred portfolio from the IRP and all short listed project bids were allowed to compete to fill the capacity shortfall. In the RFP process, the bids received should be evaluated against other actual bids, not against generic assumed units that may or may not be able to be built for the assumed costs and with the assumed operating characteristics that were assumed in the IRP.

**Q: How does this affect the analysis of the RFP responses?**

A: Because the preferred portfolio assets are fixed in time in the analysis, it is possible that some of the benefit of adding an actual unit, with known costs to RMP, might not be captured because an un-bid unit, with unknown costs to RMP, was displacing the energy of the bid unit. This has the effect of forcing bid units to not only compete against other bids from the RFP, but also to compete against generic units whose actual costs and characteristics are not known because they have not been vetted or benchmarked. This can be further seen in RMPs Confidential Response to DPU Data Request 3.12, where the Company states that a key reason that [REDACTED] went from a favorable review on [REDACTED] to an unfavorable one on [REDACTED] was a change in how Currant Creek II was modeled [REDACTED] [REDACTED] was rejected in favor of a unit that was not bid in the RFP.

**Q: What, in your opinion, would have been a more accurate way to account for future, planned resources?**

A: Every long term modeling effort is forced to deal with the fact that, at some point, known units cannot account for all capacity needs over the study horizon. The inclusion of generic units in and of itself is not a problem – it is a normal approach to the “capacity gap” that long term studies deal with. In general, however, when looking at the impacts of short term acquisitions of capacity, it is considered preferable to allow the long term generic units to “float” – that is to have the modeling software determine what would be the least cost acquisition of such generic units. This is because, as the short term acquisition parameters change, the need and timing for such generic capacity is likely to

change as well. In the case of this RFP, some portfolios had only the Lake Side unit coming online while others had both the Lake Side unit and the [REDACTED]. The acquisition of [REDACTED] the capacity (in the 2 unit portfolio) would almost certainly change the timing of future acquisitions when studying the least cost alternative.

**Q: Does this issue, in your mind, invalidate the RFP results?**

A: No, while this was a flaw in the methodology and does call some of the conclusions into question, it is not in and of itself serious enough to invalidate the entire RFP study in my opinion. RMP did attempt to work around this by studying, as a sensitivity case, the exclusion of the Currant Creek II generic unit [REDACTED]. Unfortunately, this only studies the full exclusion of Currant Creek II, rather than the potential for [REDACTED] to postpone the need for Currant Creek II, and therefore falls short of the analysis that I'm proposing.

**Q: What is the result of the exclusion of this type of analysis?**

A: The result of excluding any testing of deferral of future generic units is that the marginal RFP unit [REDACTED] was not fully reviewed for potential benefit to the full RMP portfolio. It is likely that some of the value in an incremental expansion of RFP units is directly related to such a deferral. Therefore, I believe that the value of [REDACTED] to the Company is understated in the RFP analysis. By comparing the binding Best and Final bid of [REDACTED] to the estimated future costs of a theoretical Currant Creek II unit, RMP has performed the precise type of analysis that Benchmark bids were designed to prevent. RMP would not be held to its estimates of capital costs or performance measures, while [REDACTED].

**Q: Based on the above, what is your recommendation?**

A: Based on the information presented above, I recommend that [REDACTED]  
[REDACTED]  
[REDACTED]



As a result of criticisms from the Company in rebuttal testimony, Mr. Hahn responded in part by reiterating his previous testimony:

As I stated in my direct testimony, the Company made two assumptions in the evaluation process that are inappropriate. The first inappropriate assumption was to change the in-service date of Currant Creek II to 2016 from 2018 in the later stages of the analysis. This effectively allowed a generic or proxy resource, whose cost and operating assumptions had not been vetted and which were not binding on the Company, to directly compete with RFP bid projects. The second was to fix the in-service dates of certain post-RFP resources and not allow RFP bid projects to displace those resources. The Company's response to DPU 4.23 demonstrates fixing post-RFP resources reduces the value of [REDACTED]. These assumptions made by the Company are simply inappropriate for the reasons stated above and in my direct testimony.<sup>6</sup>

Mr. Hahn made specific recommendations to the Commission regarding the procedures for future RFPs:

- In future RFPs, I recommend that certain changes in the evaluation methodology be implemented. This current RFP should not be affected by these proposed revisions.
  - The evaluation process sought specific proposals for new resources for 2014 to 2016, but fixed any new generic resources that were planned for 2017 and beyond. This “fixing” of post-2016 resources in the evaluation process prevents these generic resources from being deferred or displaced by RFP bid projects, and may understate the true value of the RFP bid projects.
  - There should be a specific prohibition against allowing generic projects to compete economically with RFP bids. Generic resources that are not locked down benchmark bids should not displace or defer projects bid into an RFP.

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<sup>5</sup> Direct Testimony of Richard S. Hahn, Docket No. 10-035-126, March 3, 2011, at lines 635-707.

<sup>6</sup> Surrebuttal Testimony of Richard S. Hahn, Docket No. 10-035-126, March 24, 2011, at lines 222-231.



- Unmet energy costs and risk adjustments are appropriate factors to include in the analyses performed by the Company, and should be included in future economic evaluations.<sup>7</sup>

The Division believes that the same problems in evaluation methodology that were identified by the Division's consultant in the Lake Side 2 approval docket exist in the current 2016 RFP proposal. The Division believes especially that the fixing of future resources remains problematic in the 2016 RFP. The Division also believes the Company should re-examine its assumptions regarding unmet energy.

In its answer to the Division data request DR 1.1 in this Docket, the Company concluded its answer with a statement regarding what happened at a workshop held on September 1, 2011: "While the parties in the workshop had questions, no party objected to the Company's proposed modifications to its evaluation process." The Division wishes to make two points. First, the workshop was the first impression parties were given of the Company's "proposed modifications" so that it would have been premature for any party to strongly "object" at that point. However, the Division informed the Company that the Division was concerned about some of the modifications, especially the fixing of post-2016 IRP resources. The Division reminded the Company that the fixing of post-2016 resources was contrary to the Division's position in the Lake Side 2 approval docket and that the Division would be looking closely at that.

The Division also notes that by fixing post-2016 resources the Company is ignoring language in the Commission Order of April 20, 2011 in the Lake Side 2 approval docket (Docket No. 10-035-126) that recognized the merit of the Division's recommendation to not fix any future IRP resources in evaluating the bids in future RFPs and would have avoided some of the trouble that arose in the Lake Side 2 approval docket. The Division believes that fixing post-2016 resources is a significant issue that the Commission should resolve in this Docket. The Division recommends that the Company not fix post-2016 resources in its bid evaluations.

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<sup>7</sup> Direct Testimony of Richard S. Hahn, Docket No. 10-126, March 3, 2011, at lines 73-85.

5. Clarification of Deferral/Acceleration. Under the section “Flexibility of Proposals” the 2016 RFP has language regarding terms “which provide PacifiCorp the ability to defer or accelerate the in-service date of the contract...” In answer to DPU data request DR 1.5, the Company appears to say that only acceleration (i.e. earlier than the requested June 2016 in-service date) of the in-service date will be considered. The Company should re-write the language in the RFP to clarify what it means in its discussions of deferral and acceleration.

6. Coal Resources. In its Introduction on page 6 of the 2016 RFP, the Company states that “bids new or existing coal resources shall be limited to a Maximum Term of less than five (5) years.” Then the Company requests that the 2016 RFP bids must be for at least five years, on page 9 (pdf version). On the surface this appears to be an absolute rejection of any coal resource bids in the 2016 RFP. The Company does list a series of resource exceptions and that do not include coal, on pages 10, 13, and 19-21. However, the Company has language in several places that imply that coal resources might be considered. For example, on page 10 a PPA from coal might meet the 5-year minimum; on page 22 the Company states “All bids from new or existing coal resources will be considered by the Company and, during the evaluation process, will be given appropriate weight based on CO<sub>2</sub> risks associated therewith.” In answering the Division’s data request DR 1.4, the Company seemed to clarify that the same CO<sub>2</sub> analyses will be applied to coal that are applied to natural gas plants or other resources CO<sub>2</sub> risk.

The Company needs to be more specific about the circumstances under which a coal resource could be genuinely considered in 2016 RFP. If the Company would accept a coal-based proposal under an exception, then it needs to clearly include this fact in the exceptions sections. If the Company really will not consider a coal resource under any circumstance, it should state that clearly as well. Again, the Company, bidders, Independent Evaluator, and regulators should not spend their time and effort with bids that the Company essentially will not consider.

7. Bidder Litigation. The Company indicates that it will accept bids from entities that are in, or threatening, “material” litigation against the Company. The only specific criterion for “materiality” mentioned by the Company is that the dollar amount at issue is “in excess of five (5) million dollars...” The Division questions the propriety of allowing into the bidding any

entity that is in, or threatening, litigation against PacifiCorp. In any case the Division is of the opinion that \$5 million is too high a threshold for materiality. In other contexts, such as general rate cases, the Company seems to consider much lower amounts to be material. The Company should have to demonstrate that its language regarding litigation and the level of materiality is a common industry practice. The Division believes that allowing entities to bid into the 2016 RFP who are litigating against the Company could create the appearance of impropriety. For example, if such a bidder were a winning bidder, then concerns could be raised that the win might be part of some quid pro quo with respect to the litigation. Similarly, if such a bidder were to lose, the impression might be that the Company found ways to reject an otherwise good bid to “punish” the bidder. To argue that the Independent Evaluator would offer complete protection against either of these scenarios is to assume omniscience of the Independent Evaluator regarding the Company’s or bidder’s motivations and analyses. At a minimum, the Company should clarify the circumstances under which it would negotiate with a bidder that was suing it, and why that should create no potential appearance of impropriety.

8. Typographical Edits. Finally, there are a handful of typographical and similar errors in the draft proposed RFP that have been identified by the Division:

a. On page iii in the Table of Contents, Section 5, following C. 5. is an alphanumeric character “\_Toc194309325.”

b. In the middle of Section 1, Introduction, is a load and resource table and a capacity table from the IRP. The Division believes that these tables present useful information, but should be included with the latest IRP data.

c. In the third line from the top of page 15 (pdf version), the sentence should probably read “the Bidder will be responsible for the purchase of fuel....”

d. In the last full paragraph on page 15 (pdf version), near the middle left it should read “Attachment 17” (i.e. not plural).

e. The top of page 16 (pdf version), the first sentence of the last paragraph under Section 3, should be revised for clarity: "...and all Owners' Costs Under and EPC Owner's Development Costs" is unclear.

f. Near the bottom of page 23 (pdf version), first paragraph under "C. Intent to Bid Forms" has the sentence "current bidders in the process must provide an "Intent to Bid Form" to confirm their participation and update any prior information provided in Appendices A and B." This appears to be a legacy statement from the previous RFP.

g. A flow chart "Figure 1" in the previous RFP, which would have been placed at about page 45 (pdf version) of the RFP, has been deleted. The Division believes that an updated version of this flow chart would be helpful and should be included.

h. The last sentence at the bottom of page 44 (pdf version) should probably read "...information reasonably and readily available...."

i. The paragraph under "Calculation of the Price Score" on page 46 (pdf version), does not seem to describe the formulas very clearly and should be re-written. Alternatively the explicit formulas should be written out.

## CONCLUSION

Utah statutes state,

In ruling on the request for approval of a solicitation process, the commission shall determine whether the solicitation process: . . . is in the public interest taking into consideration:

(A) whether it will most likely result in the acquisition, production, and delivery of electricity at the lowest reasonable cost to the retail customers . . .

(B) long-term and short-term impacts;

(C) risk;

(D) reliability;

(E) financial impacts on the affected electrical utility; and

(F) other factors determined by the commission to be relevant. (Utah Code Ann. § 54-17-201(2)(c))

Based on the discussion herein, the Division believes that it will be at best problematic that a winning bid under the Company's proposed 2016 RFP is in fact in the public interest. In particular, the Division is concerned that, given the indentified shortcomings in the Company's proposed 2016 RFP, it will be difficult to determine whether the winning bid is in fact the least-cost, least-risk resource.

State statute also indicates that in the review of the Company's solicitation process,

The commission shall:

- (i) approve a proposed solicitation process;
- (ii) suggest modifications to the proposed solicitation process; or
- (iii) reject a proposed solicitation process. (Utah Code Ann. § 54-17-201(2)(f)).

Therefore, the Division recommends that the Commission reject the Company's proposed solicitation process. In making this recommendation, the Division weighs carefully its understanding of the consequence of a major delay in the 2016 RFP schedule at this time, namely, that it will likely mean the Company will struggle to make an on-line date of June 2016. However, it was the Company that chose to file its application with little or no leeway in its schedule. Rather than filing a proposed solicitation process that erred, if at all, on the side of caution to insure approval, the Company has failed to heed past recommendations. In fact, the Company has filed an application that is, in some respects, a step backwards from the previous one. The Company's inability to plan adequate time and contingencies should not be the

Commission's emergency. The Division recommends that the Commission consider extending the time for the solicitation process by 30 to 60 days pursuant to Utah Code Annotated 54-17-201(2)(f) in order to give time for the revision and vetting of the 2016 RFP.

The Division recommends that the Commission suggest to the Company the Division's recommendations herein, and other changes the Commission determines warranted, and invite the Company to revise and resubmit its Application to the Commission for approval as soon as possible.

While the Division identifies a number of relatively minor editorial or clarifying changes, it also recommends a number of substantive changes. These recommended changes follow directly from the discussion of RFP issues in this memorandum. These recommendations are:

1. The Company should not fix any IRP resources after 2016.
2. The Company should prepare a benchmark bid.
3. The Company should demonstrate that its "All-Source" RFP does not, in reality, heavily advantage Currant Creek EPC bidders. Or alternatively, that the Company amend its 2016 RFP to be an RFP solely at its brown field Currant Creek site.
4. The Company should reconsider its position that any bidder who is in, or has threatened, litigation against the Company. In the alternative, the Company should demonstrate that its language regarding litigation and the level of materiality is a common industry practice and does not create the potential appearance of impropriety.
5. The Company should clarify the circumstances (if any) under which a coal resource would be seriously considered.
6. The Company should reinstitute language in the 2016 RFP allowing for some inflationary or cost-adjustment factors such as was included in prior RFPs.

CC: Michele Beck, OCS  
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