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Memorandum

To: Public Service Commission

From: Division of Public Utilities
Constance White, Director
Artie Powell, Manager, Energy Section
Ron Slusher, Technical Consultant
Andrea Coon, Technical Consultant

Subject: In the Matter of the Application of PacifiCorp for Approval of a 2009 Request for Proposals for Flexible Resource; Docket No. 05-035-47

Date: October 13, 2006

Background

On June 27, 2005, PacifiCorp (Company) filed an application to issue a Request for Proposals (RFP) in order to procure a resource needed for summer 2009. After several months of meetings and the issuance of a draft RFP, the Company moved to suspend the schedule on October 19, 2005. This motion was granted by the Commission on October 21, 2005. After PacifiCorp reviewed its Integrated Resource Plan (IRP) Update in October and November of 2005, it determined that there was no longer a resource need in 2009. Instead, the resource need had shifted to the summer of 2012. The current RFP filing replaces that originally filed under this docket and requests resources to begin serving load in the summers of 2012, 2013, and 2014. The Division of Public Utilities



(Division) filed initial comments on August 16, 2006. The Independent Evaluator filed its report on August 30, 2006. PacifiCorp followed up with reply comments on September 19, 2006. A technical conference and credit workshop were held on September 21, 2006. Due to discussions during the technical conference, the Commission rescheduled the Docket to allow for an updated draft of the RFP and further comments from interveners. The following are the Division's comments on the updated draft RFP as filed by the Company on October 4, 2006.

Analysis

There are still areas of concern to the Division in the draft filing. Due to the short time period allotted for review of this document and the extensive changes made, we have identified several issues that we will address in these comments: the overall readiness of the document for general release, inferred or imputed debt used in the screening process, credit requirements, the purpose behind the new O&M requirements, and IPP3 as a benchmark option. The Division is also looking to the comments of the Independent Evaluator (IE) and other stakeholders, including possible bidders, to bring to light other remaining issues.

Overall Document Readiness for General Release

The Division has some general concerns with the state of the RFP document. Due to both the sheer number of edits that have occurred as well as the short time frame in which these changes occurred, the document has areas that are confusing, inconsistent,

and do not read as well as we would hope. The Division is concerned about these issues because it is vital to ensure that the style of the RFP does not set a barrier to a bidder submitting a complete and initially acceptable bid. While spending time cleaning up grammar and punctuation may not seem important, a document that is unclear or confusing as to requirements of bidding may lead to a less than full market response. There could be otherwise viable bids that are rejected for failure to conform to unclear requirements. There could also be many otherwise unnecessary questions directed toward the IE. The Company should continue to work with the IE and the Division to ensure that the final RFP is cleanly and clearly written with all requirements clearly articulated.

Debt Inference or Imputation

The issue of debt imputation arose in the pricing methodologies docket for large QFs, Docket No. 03-035-42. In that docket the Company's position was essentially the same as it is stated in the draft RFP document (Section 2.H.5): entering a contract that is deemed to be either a capital or operating lease "imputes" costs to the Company and, therefore, should be passed to the contract. In the QF case, the imputation resulted in an offset that lowered the price to be paid by the Company for the QF's power. In the RFP document, the imputed cost would increase the cost of the bidder's proposal. PacifiCorp proposes to "take into account [the] cost associated with direct or inferred debt as part of its economic analysis in the final screening." (Draft RFP Section 2.H.5 – Cost Associated with Direct or Inferred Debt)

The Division filed testimony on the debt imputation issue in Docket No. 03-035-42.¹ While the Division agreed in principle with the Company that the designation of a contract as an operating lease² imposed a real cost on the Company, which, at least in theory, could increase the cost of capital to the Company and thus increase rates to the utility's customers, the Division's testimony raised serious concerns about the computation of that cost. In brief, the Division's testimony argued that the magnitude of the cost or impact on the Company for an operating lease was highly speculative and recommended that the Commission adopt a much lower "risk factor" than that proposed by the Company. The Company proposed using the methodology developed by Standard and Poor's which uses a 50% risk factor; the Division recommended using a 15% risk factor because of the highly speculative nature of the impact of the imputation. Other parties to the docket recommended that, given the uncertainty surrounding the issue, the QF's price not be adjusted for the imputed debt costs. In its final order in Docket No. 03-035-42, the Commission rejected both the Company's and the Division's recommendations.

While the Division has not seen any evidence to change its position on the matter, the Division anticipates that the use of debt imputation in the screening process will be no less controversial here as it was in the QF docket. Indeed, some experts have argued that

¹ See Direct and Surrebuttal Testimony of Dr. William Powell, Division of Public Utilities, Docket No. 03-035-42.

² There was little if any objections to the Company's proposed treatment of a contract that had been designated as a capital lease. If a contract is determined to be a capital lease, debt equal to the present value of the lease payments is added directly to the Company's balance sheet according to standard accounting practices. If a contract is determined to be an operating lease, the debt is an inferred amount determined by rating agencies for purposes of rating the Company's debt instruments.

the Company's self-build options in general impose at least as much risk on ratepayers as does a contract with a third party bidder. This is an issue that was not fully investigated in the large QF pricing docket. Therefore, the Division recommends that the Commission take testimony on this issue for the purpose of making a final decision as to the appropriateness of imputed debt as a screening tool and the proper method for determining the magnitude of the imputation.

Credit Requirements

In previous comments in this Docket, the Division expressed concern over the fact that the methodology and matrix outlining the manner in which PacifiCorp will determine the required credit assurances for a bid project was undisclosed. The Company has since responded to those concerns by releasing the matrix in the updated RFP and by holding a credit workshop on September 21, 2006, during which the methodology was discussed. The matrix showed the amount of credit that bidders would be required to obtain by credit rating and by plant size. The Division does not have any substantive problems with the credit issues as presented in the current draft of the RFP, but will reserve final judgment until we see the feedback from any potential bidders into the RFP as these bidders would be better qualified to point out possible problems with the credit methodology or matrix. We recommend that the Company be prepared to discuss any stakeholder comments during the settlement conference scheduled for October 19, 2006.

Intent and Purpose of Newly Proposed O&M Bid Requirements

In the October 4, 2006, RFP draft, the Company added language to the Asset Purchase and Sales Agreement bid options that would require the bidders to operate and maintain a facility for up to ten years. The Division is concerned that this condition could be a barrier to bid for any entity that is well ready and able to design and build a facility but not necessarily operate it long term. The Division would like to explore the reasoning behind this condition with the Company during the upcoming settlement conference, as it seems to be a condition that was not necessarily applied to other recent “turn key” facilities under contract by the Company.

IPP3

The Division has some lingering concerns over the use of IPP3 as a benchmark in this RFP. As we discussed in our comments in Docket No. 05-2035-01 and prior comments in Docket No. 05-035-47, the Division has concerns regarding the vetting process and previously committed investment in this facility. Our previous discomfort regarding this plant being built as a sub critical facility were addressed by the Company in the form of documents (DPU Confidential 1 & 2) that showed recent changes that alleviated our concerns. We still have not, however, received any other documents from the Company dealing with our previously outlined concerns. We have been told that such documents are forthcoming, but we are unwilling to dismiss our concerns until such documents have been received and analyzed by Division personnel. We recommend that the Company provide the Division with the promised documents prior to the settlement

conference scheduled for October 19, 2006, allowing sufficient time for Division review and analysis.

Recommendations

The Division makes the following recommendations for this draft RFP:

1. The Company should continue to work with the IE and the Division to ensure that the final RFP is cleanly and clearly written with all requirements clearly articulated.
2. The issue of debt imputation should be presented to the Commission through testimony for the purpose of making a final decision as to the appropriateness of imputed debt as a screening tool and the proper method for determining the magnitude of the imputation.
3. The Company should be prepared to discuss any stakeholder comments regarding the credit matrix or methodology during the settlement conference scheduled for October 19, 2006.
4. The Company should explain its intent and/or purpose behind the new O&M requirements set forth for Asset Purchase and Sales Agreement bids.
5. The Company should provide the Division with the promised documents regarding its involvement in IPP3 prior to the settlement conference scheduled for October 19, 2006.

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