

BEFORE THE UTAH PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF)
PACIFICORP FOR APPROVAL OF A 2009 REQUEST) Docket No. 05-035-47
FOR PROPOSALS FOR FLEXIBLE RESOURCE)

COMMENTS OF LS POWER ASSOCIATES, L.P.

Pursuant to the Utah Public Service Commission’s (“Commission”) May 4, 2006, Amended Scheduling Order in the above-captioned docket, LS Power Associates, L.P. (“LS Power”) submits the following comments on PacifiCorp’s “2012 Request for Proposals Base Load Resources” which was filed by PacifiCorp¹ on July 11, 2006 (“Draft RFP”).

LS Power’s Interest

LS Power is part of the LS Power Group, which is a privately held group of companies formed in 1990. LS Power Group’s principal business is to develop, own, manage and invest in reliable and environmentally responsible generation throughout the United States. The LS Power Group is one of the country’s largest and best capitalized independent power producers. It has developed ten individual electric generation facilities in the United States which total approximately 6400 megawatts of generation capacity. LS Power Group currently owns 8600 megawatts of generation capacity and manages an additional 1100 megawatts on behalf of third parties. It also has an in-depth and up-to-date understanding of the financial markets as they relate to the financing of power generation projects. In March 14, 2006 LS Power Group along with its joint owners financed the construction of its \$1.2 billion, 665 MW Plum Point baseload coal facility located in Osceola, Arkansas. That project will be delivering power to its

¹ LS Power understands that for operations in Utah, Wyoming and Idaho, PacifiCorp changed its name to Rocky Mountain Power on July 17, 2006. Because the Commission has apparently not yet made a change in the docket or caption, LS Power has for purposes of these Comments used the name PacifiCorp.

cooperative, municipal and investor-owned utility customers under long term power-purchase power purchase agreements and joint ownership arrangements. In the past 2 years, LS Power Group has raised in excess of \$4.5 billion in debt and equity for development, construction, acquisition, and refinancing of power generation facilities.

LS Power Group is an active participant in the market and is interested in supplying Utah with low-cost generation. LS Power Group participates in many requests for proposals (“RFPs”) for power generation resources in the U.S. and has been the successful bidder in a number of those solicitations.

LS Power Group currently has a number of baseload resources under development. LS Power Group is currently developing several projects in Eastern Nevada which could support delivery of baseload power to PacifiCorp: 1) a 1,600 MW coal-fired generation facility; 2) a 500 kV transmission line that will connect its generation project in Eastern Nevada to the substantial load growth occurring in the southern portion of the state; and 3) a 200 MW wind generation facility. LS Power Group is in the early stages of development of a baseload generation facility in Colorado and continues to explore the feasibility of development of a project in Utah as well.

LS Power’s Comments

LS Power has reviewed the draft “2012 Request for Proposals Base Load Resources” (the “Draft RFP”) and, given its experience participating in RFP processes across the country, would like to provide the following comments for consideration.

In general, third party developers like LS Power are encouraged by State Commissions (like in Utah) that utilize the concepts of competitive procurement to ensure least cost delivery of reliable power to ratepayers. Full use of an independent evaluator’s expertise provides a degree of independent review that is critical to ensure confidence in the fairness and transparency of the

evaluation process. That increased confidence should result in an increase in the likely number of bidders, providing the broadest possible spectrum of potential solutions to meet PacifiCorp's expected capacity needs most economically.

LS Power is concerned that the proposed economic evaluation of proposals may unfairly penalize proposals that entail Power Purchase Agreements ("PPAs") and proposals that require transmission upgrades, taking account only of the costs of such proposals without attempting to identify all of the benefits. This one-sided approach reduces the pool of potential bidders and may lead to the inefficient result of eliminating the best overall supply resources for ratepayers. LS Power believes that a broad base of bidders serves PacifiCorp's ratepayers best by ensuring the best available intellectual, financial and technical resources are on offer to meet an identified need.

LS Power's comments center on several areas of the Draft RFP:

- Creditworthiness and Experience Standards
- Inferred Debt Penalty
- Transmission Upgrade Costs
- Extension of Proposal Validity

Creditworthiness and Experience Requirements

It is important to establish creditworthiness and experience of bidders, and the burden is properly on bidders to demonstrate sufficient creditworthiness and experience to be able to supply PacifiCorp under a long-term supply arrangement. LS Power's concern with the Draft RFP is that strict application of what could be unduly stringent requirements has the potential to severely limit participation in the process, thereby limiting available alternatives for ratepayers.

The need for PacifiCorp to protect itself against the credit risks of its counter parties is understandable. It appears that the Draft RFP is taking a reasonable approach in requiring bidders either to be investment grade or to post security at an adequate level. However, as PacifiCorp did not include its proposed credit requirements in the Draft RFP, LS Power is unable to comment on the proposed amount of security to be posted and whether the amount is appropriate given its most recent contracting and project finance experience. An unreasonably high threshold in PacifiCorp's promised Credit Matrix would, however, place an undue burden on bidders and give self-build options a significant advantage – something clearly not to the ratepayers' benefit.

To ensure the widest consideration of potential options and solutions to meet PacifiCorp's capacity needs, evaluation of credit requirements should be done in depth with each shortlisted bidder. This evaluation should be based on the economics of each bid. As part of that process, bidders should be allowed to negotiate mutually acceptable credit arrangements with PacifiCorp in order to balance the need for performance assurance with the costs associated with providing such security. There can be significant benefits associated with procuring power from third party suppliers, such as: (a) elimination of ratepayer prepayment of development and construction costs; (b) provision of performance guarantees²; (c) increased wholesale competition³; and (d) diversification of suppliers⁴. These types of benefits are not captured in the evaluation process proposed in the Draft RFP. By increasing the cost of third party bids without fully considering all of the potential benefits, there is the possibility of inefficient results – that is, selecting self-

² For an extreme example, consider the worst-case scenario of a generation plant that poorly performs in terms of efficiency and output. In the case of a utility-sponsored project, ratepayers will continue to pay the capital costs and the resulting higher fuel costs. In the case of an IPP with a PPA, ratepayers will only pay for fuel at the contractually guaranteed heat rate, and only pay for the actual tested capacity of the facility.

³ Studies have estimated the savings to consumers resulting from wholesale electricity competition in the U.S. at nearly \$5 billion annually.

⁴ Currently, ratepayers have significant exposure to PacifiCorp as the primary supplier of energy. Purchasing power from a third-party supplier under a PPA diversifies this exposure.

build resources which are not necessarily the best deal for ratepayers when considering all of the associated costs.

Bidders should be allowed to negotiate other acceptable credit arrangements rather than conform to an unreasonably high or formulaic minimum requirement. Ultimately, the winning bidder and PacifiCorp must settle on a level of mutually agreeable security, taking into account the factors relevant to the particular bid and bidder.

Similarly, the Draft RFP proposes an experience threshold that could inappropriately limit participation in the RFP. Specifically, the Draft RFP states that “...*the bidder project development team has successfully completed the developmental and commissioning of at least one generation project with characteristics similar to the proposed project.*” This experience requirement may have the unintended result of limiting competition altogether by discouraging bidders from submitting proposals that might offer a credible, low-cost option benefiting ratepayers, but for failure to meet the experience threshold as defined. Given that the RFP is for baseload resources, and very few new pulverized coal, IGCC, or nuclear power plants have been commissioned in the past 15 years in the U.S., strict application of this provision can only serve to limit participation. Even most investor-owned utilities in this country would not be able to meet this experience requirement if a baseload facility was determined to be the best option for ratepayers. This category of evaluation in today’s market for construction of generation capacity should be more subjective, with emphasis on a bidder’s recent development, ownership and operational experiences. For example, a company that developed a pulverized coal plant in 1970 would have a very different experience today in all aspects of the project’s development and should not be given “extra credit” when compared to developers that have been in the marketplace for equipment, financing and EPC contractors in the last 5 or so years. Bidders

should be required to establish experience but without strict application of an unreasonable standard.

Inferred Debt Penalty

The Draft RFP includes an “inferred debt” penalty on proposals for a PPAs based on an article (or “guidance”) by Standard & Poors (S&P). Upon closer examination of all available information, the inferred debt penalty is inappropriate and would unfairly increase the cost of a PPA-based proposal relative to utility-self build proposals. Notably, S&P is the only credit agency to include any sort of adjustment related to power purchase agreements. Moodys’ and Fitch are explicit that they do not simply treat a PPA as imputed debt in their credit evaluation of utilities. Furthermore, the S&P article does not state that an equity adjustment of the nature proposed by PacifiCorp is a result of the consideration of imputed debt in S&P’s credit review. Rather, S&P states in its guidance that its credit review is the result of a thorough analysis of both qualitative and quantitative factors. It states that calculating the imputed debt of PPAs is a standard way to evaluate the magnitude of the obligation under the PPA, but not that any equity infusion would be specifically required to maintain the utility’s credit. In fact, S&P has never downgraded a utility solely due to the impact of imputed debt calculated by S&P as part of its credit review. Furthermore, , the Draft RFP’s proposed approach – which assumes that PacifiCorp would add an amount of equity to its capital structure to offset the calculated “equivalent debt” of a PPA – is, at a minimum, unsuitable for the initial bid evaluation. It is doubtful that: (a) such equity would be required to maintain current bond rating levels; or (b) PacifiCorp would in fact add such equity when it enters into a PPA. As a prudent financial manager, PacifiCorp would be expected to issue equity only as

necessary to fund capital expenditures, not simply to offset the rating agency's "equivalent debt". At the time of any such capital expenditures, PacifiCorp may very well be able to finance its needs without a change to the relative amount of equity in its capital structure. Therefore, adding a cost for such equity to the PPA proposals would effectively be imposing an unnecessary penalty – first on bidders, and then on ratepayers, as IPP bids are burdened with these synthetic costs. Finally, as stated above, there are benefits to PPAs which should be quantified and in the evaluation, which are currently not accounted for in the Draft RFP. In sum, by including an inferred debt penalty as a cost without fully quantifying and evaluating the benefits of PPAs, the Draft RFP would result in a one-sided evaluation that is likely to lead to inefficient results, at the expense of ratepayers.

If an inferred debt penalty is used, LS Power questions the use of a 50% risk factor. S&P's guidance is that the "equivalent debt" would be calculated as the net present value of the fixed contract costs multiplied by a factor ranging from 10 - 50%. The factor used to calculate the "equivalent debt" is dependent upon a number of issues, but will definitely have a large impact on the net equity cost. S&P's guidance suggests this factor would be closer to 10% if the PPA is selected as a result of a competitive bidding process with regulatory oversight. And given that the other two ratings agencies do not use anything like the "factor" approach used by S&P, the Draft RFP's proposed 50% penalty places a PPA-based approach at an unreasonable disadvantage.

Transmission Upgrade Costs

In Section 4.C.1, the Draft RFP evaluates only the cost of electrical infrastructure associated with proposals, without recognition of the benefits of such infrastructure. There is a

growing recognition across the industry, and by the Commission itself, of the need for significant transmission infrastructure investment. The benefits of such investment include:

- (a) increased reliability;
- (b) significant overall energy savings through efficient generation dispatch and economy energy purchases;
- (c) fuel diversity including increased access to remote renewable resources; and
- (d) reduced rates to ratepayers through economy energy sales to third parties.

Of course, one reason to exclude these potential benefits from the evaluation is that it is difficult to quantify these benefits. Fortunately, there are a number of excellent Integrated Resource Planning tools available to PacifiCorp for the bid evaluation that are designed to perform exactly this type of analysis, and which could and should be used to fairly quantify the benefits associated with transmission upgrades required to integrate a new generation proposal. Given that it is possible to evaluate the benefits of transmission associated with a proposal, and such benefits could be significant, it is important that the evaluation of transmission associated with proposals include the overall impact of the proposal, and not just the incremental transmission costs. To only include the costs associated with transmission investment is likely to lead to inefficient results, with the selection of a resource which is not best overall for ratepayers.

Extension of Proposal Validity

The Officer Certification Form in Appendix E of the Draft RFP appropriately requires bids to remain in effect through the end of the bid evaluation period. However, the Draft RFP also provides that the bid evaluation period is only an estimate and subject to change at PacifiCorp's sole discretion. This puts another "penalty" on the third party proposals that likely isn't applicable to self-build proposals. This provision is simply unreasonable, and can result in

higher overall costs. By increasing the timing uncertainty of the entire RFP process, the Draft RFP ensures that IPPs must weigh these additional risks, and potentially price them into their bids, to the ratepayer's ultimate detriment.

The proposed schedule should be binding on PacifiCorp without the ability to extend the process. In the alternate, if there are delays in the process, bidders should have the opportunity to re-evaluate the validity of their original proposal.

Summary and Recommendations

The final RFP should be revised to allow the bidders flexibility to provide the most competitive bid possible. This would be accomplished by containing reasonable requirements and flexibility related to creditworthiness and experience. The inferred debt penalty proposed for PPA proposals should be eliminated to ensure such proposals are given the opportunity of a fair evaluation. The transmission evaluation of proposals should include consideration of the benefits of associated transmission upgrades in the proposal evaluation process. Finally, a mechanism should be added that allows bidders to re-evaluate and adjust their proposals in the event the bid evaluation period is extended.

LS Power appreciates this opportunity to participate in the RFP process.

Dated this 16th day of August, 2006.

/s/ MICHAEL J. MALMQUIST
Attorney for LS Power Associates

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of August, 2006, I caused to be e-mailed and/or mailed, first class, postage prepaid, a true and correct copy of the foregoing **Comments of LS**

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