BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PacifiCorp for Approval of a 2009 Request for Proposals for Flexible Resource	**<u>DOCKET NO. 05-035-47</u>** **COMMENTS OF THE NORTHWEST INDEPENDENT POWER PRODUCERS COALITION ON PACIFICORP'S DRAFT REQUEST FOR PROPOSALS 2009**

The Northwest Independent Power Producers Coalition ("NIPPC") hereby submits its response to this Commission's Scheduling Order dated July 20, 2005, requesting comments from Parties on PacifiCorp's 2009 Request for Proposals for Flexible Resource. NIPPC also is using this filing as a request for intervention and party status in Docket No. 05-035-47.

The Northwest Independent Power Producers Coalition

The Northwest Independent Power Producers Coalition ("NIPPC") is a broad-based association that represents the developers, owners and operators of nonutility power plants active in the region's electric power supply marketplace. Taken collectively, members' Northwest projects include- 3,255 megawatts ("MW") in operation and another -1,700 MW of fully permitted projects. .

Coalition members have made substantial investments in order to generate cost-effective electricity for electricity consumers. On behalf of its members, NIPPC is participating in this proceeding and others like it, seeking the adoption of policies and procedures that will assure that Utah consumers have access to least-cost, best-fit resources, not just now, but in the future.

Summary of Comments and Recommendations

NIPPC commends PacifiCorp for its substantial efforts in connection with the RFP and for the significant public input solicited and considered. As discussed in more detail below, however, NIPPC has significant concerns over several aspects of the RFP:

1. the unduly burdensome credit requirements for creditworthy bidders;
2. the fact that PacifiCorp is calling for the application of an inferred debt, or debt-equivalency, risk factor of 50 percent, which unduly discriminates against long-term power purchase agreements (PPAs) and which creates an irreparably damaging bias against PPAs; and
3. the fact that “variable interest entities” are, in effect, discouraged from participating – to the point where they are not eligible to submit proposals;
4. the fact that RFP responses submitted by December 1, 2005, must be kept open until March 2007, despite the fact that market conditions may change significantly in that time frame.

Given these shortcomings, and fact that the RFP effectively precludes participation from many, if not most, independent power producers, NIPPC recommends that the Commission, in its forthcoming Order of September 30, 2005, require PacifiCorp to remedy its RFP conditions, as recommended below:

1. **Credit Requirements.** There are a number of credit support mechanisms other than guarantees and letters of credit that have been successfully used by independent power producers and accepted by the utilities or load-serving entities (LSEs) who sponsor supply solicitations and who ultimately become the counterparty to a long-term power purchase agreement (PPA) under which the capacity and energy of a particular generating plant is produced and sold.

These include subordinate liens in project assets, step-in rights, agreements to limit the amount of debt that can be incurred at the project company level, and arrangements under which the project lenders commit to assume the project company's obligation to perform under the PPA if they foreclose on the project assets. NIPPC recommends that the Commission ~~order~~ require PacifiCorp to amend the credit conditions in its RFP to reflect the ability of the PPA to incorporate subordinate liens, step-in rights, project finance indebtedness at the holding company level, or the ability of project lenders to assume PPA obligations.

2. **Application of Inferred Debt, or Debt Equivalency, Penalty.** In order to ensure comparability in the evaluation of proposals submitted to satisfy the RFP requirements, including the utility self-build option, the Commission should undertake one of the following options:

- Strike this section from the RFP;
- Reduce to risk factor to a maximum of 10 percent, which more accurately reflects Standard & Poors' current thinking in regard to the application of risk factors~~Reduce to risk factor to a more realistic 10 or 20 percent, which more accurately reflects the risk associated with cost recovery, according to the Standard & Poors philosophy~~;
- Ensure comparable assessment of all risks and costs of both the competitive proposals under the RFP and any proposed PacifiCorp self-build alternative during the bid evaluation process;
- Consider the provision of a return on the PPA "asset" for PacifiCorp, since it will be managing the performance of the contract, similar to what it does for the performance of its own power plants; or
- Consider the imposition of additional equity in the context of a PacifiCorp cost-of-capital proceeding, where all of the utility's risks and costs can be considered on a broader basis, rather than in this single bid evaluation.

3. **Exclusion of Variable Interest Entities.** The RFP disqualifies participation by parties known as variable interest entities (VIEs). Despite the attempt by the Financial Accounting Standards Board to provide clarity on the VIE issue in its December 2003 revised Interpretation No. 46, there is no consensus among the

accounting and auditing industries as to which special purpose entities constitute VIEs and which would trigger VIE accounting treatment. Therefore, it is not prudent for a bidder to represent unconditionally that a proposed supply project would trigger VIE tax and accounting treatment. Instead, NIPPC recommends that VIEs be considered in the RFP process and that any adverse cost effects of VIE treatment, after considering the capital structure and projected earnings profile of the VIE, be taken into account alongside the overall costs and benefits of the utility self-build options and other proposals.

4. **RFPs Must Be Kept Open Until March 2007.** NIPPC recommends that the RFP allow for enough flexibility so as to enable the winning bidder to work with PacifiCorp to make any necessary adjustments in the PPA, in order to accommodate changes in the marketplace and business environment that may occur between December 2005 and March 2007.

NIPPC's Detailed Comments and Recommendations

NIPPC believes that the Commission's primary role in approving the PacifiCorp RFP is threefold: 1) to ensure that the RFP is structured in a manner that will attract maximum participation by potential suppliers; 2) to ensure that customers of Utah Power get the best deal in terms of supply assurance, prices for energy and capacity, and risk assumption; and 3) to ensure that PacifiCorp and Utah Power are able to avail themselves to the optimal flexible resource, in terms of price, risk and cost impact, as well as counterparty performance under the type of contract ultimately selected.

All of these objectives lead toward a credible and transparent RFP process that does not preclude attractive, viable and responsible resource options, and that does not minimize participation such that the PacifiCorp self-build resource option is the only remaining alternative. The customers of Utah Power deserve an RFP process that will maximize RFP participation and minimize the development, construction, operation and ongoing business risks that they otherwise would assume under the self-build alternative.

1. The Commission should not approve the following credit requirements included in the proposed RFP:

AAA/Aaa	**$0**
AA+/Aa1	**$0**
AA/Aa2	**$0**
AA-/Aa3	**$40,795,260**
A+/A1	**$89,007,840**
A/A2	**$135,984,200**
A-/A3	**$135,984,200**
BBB+/Baa1	**$182,960,560**
BBB/Baa2	**$229,936,920**
BBB-/Baa3 and below	**$324,507,750**

NIPPC Comments*:* Pacificorp's imposition of a guaranty or letter of credit requirement in an unreachable amount as the exclusive method of satisfying credit criteria is unreasonable and unduly discriminatory. The effect of these credit requirements, which are unnecessary, would be to exclude project-financed proposals from the RFP process. The highest rating that a construction-phase, single-asset power project could hope to achieve would be BBB- (the lowest of the "investment grade" ratings), which would require $324,507,750 of credit support, an amount that could exceed the all-in cost of the project and that is at least 10 times higher than the amount of credit support that has typically been required for similarly sized projects. Project finance lenders will not supply letters of credit in an amount that is even remotely close to what PacifiCorp would require.

Pacificorp's severe credit requirements address a fictional issue. Although the last five years have been a turbulent time for the independent power industry, that turbulence has been the direct result of the transition to, and opposition against, organized markets for energy, capacity and ancillary services. The fact that such markets have not been allowed to develop and mature in order to acquire the necessary liquidity and revenue streams for adequate risk management and capital recovery for merchant generation does not translate to the long-term PPA, physical tolling service agreement or asset purchase and sale agreement markets contemplated in the PacifiCorp RFP.

In these markets, and especially those with long-term PPAs, it has been very rare that stand-alone independent power projects with long term firm offtake agreements have not performed their contracts. In fact, over the past 30 years, the risks of nonperformance and associated cost recovery for a utility-built and owned power project have been higher than those of independent power projects with long-term PPAs.[1]

It is true that some respondents may propose projects that are not creditworthy, e.g. projects constructed without EPC contracts, long term maintenance agreements or adequate insurance programs, or projects that will be used as collateral for unrelated obligations of the project sponsors. But respondent project companies making PPA proposals that will be supported by strong EPC contracts and other risk-mitigating commercial arrangements with reputable vendors and that will commit that the project

[1] See discussion on relative risks of cost recovery for utility plants and competitive plants; Electric Utility Resource Planning: The Role of Competitive Procurement and Debt Equivalency; GF Energy LLC for the

company's only business and only obligations will be restricted to the purpose of owning and operating the proposed project are highly creditworthy and do not require credit support of the magnitude suggested by PacifiCorp.

There are a number of credit support mechanisms other than guarantees and letters of credit that have been successfully used by independent power producers and accepted by offtakers such as LSEs like PacifiCorp’s Utah Power subsidiary. These include subordinate liens in project assets, step-in rights, agreements to limit the amount of debt that can be incurred at the project company level, and arrangements under which the project lenders commit to assume the project company's obligation to perform under the offtake agreement if they foreclose on the project assets. Pacificorp's imposition of a guaranty or letter of credit requirement in an unreachable amount as the exclusive method of satisfying credit criteria is arbitrary, unnecessary and unreasonable.

There will be few respondents, if any, who will be able and willing to meet Pacificorp's proposed credit requirements for-single asset PPAs or tolling agreements. Those respondents who do propose to meet the requirement will price into their proposals the substantial cost of maintaining the huge amount of credit support, thereby unnecessarily increasing the cost that will be ultimately passed through to Utah Power's retail customers in the unlikely event that the pricing is still competitive enough for the proposal to be selected.

As a consequence, the unduly burdensome credit requirements will substantially lessen the number of otherwise fully qualified bidders – perhaps to the point that PacifiCorp will find it convenient to default to a self-build supply option that is not

Electric Power Supply Association ; July 2005; pp. 7, 14, 34-35.

subjected to a market test to ensure it is the best outcome for the utility's retail customers. Therefore, the Commission should reject the credit requirements, as proposed, on the basis that they are unjust, unreasonable and unduly discriminatory against the competitive option. Rather, the Commission should accept a modified set of requirements that are less burdensome and that allow a degree of flexibility, as noted above, that will ensure a viable number of qualified and eligible RFP respondents.

2. The Commission should endeavor to remove bias in the bid evaluation process in regard to "inferred debt" and to provide symmetry between competing proposals and the utility self-build option, as far as the evaluative process is concerned.

NIPPC Comments*:* PacifiCorp has decided to account for inferred debt in its evaluation of some of the proposed RFP responses by applying a risk factor of 50 percent to the capacity revenues associated with a long-term PPA. This practice of applying a "debt-equivalence" risk factor was originally proposed by Standard & Poors in 1990 and has been refined over time by credit rating agencies. In this proceeding, such an arbitrary risk factor fails to consider the fact that cost recovery under a long-term PPA approved by a state regulatory commission has traditionally less risky than cost recovery under a rate-based utility plant, especially the large, base load power plants constructed during the 1970s and 1980s. the application of debt-equivalency and a risk factor of 50 percent in the bid evaluation process fails to consider the salutary effect of S.B. 26, enacted during the 2005 General Session of the Utah Legislature.[2] This bill provides the necessary assurance for cost recovery on investments in “significant energy resource decisions,” such as those associated with long-term PPAs, whose costs have been found to be prudent and approved by the Commission. This law renders null the need for application of a 50 percent risk factor on a long-term PPA. ~~Further, the application of debt-equivalency and a risk factor of 50 percent in the bid evaluation process fails to consider the salutary impact of Senate Bill 26, enacted into law in 2004. This bill provides the necessary assurance for cost recovery on investments in new supply resources such as those associated with long-term PPAs. This law effectively renders null the need for application of a risk factor on a long-term PPA.~~ Finally, in the absence of a comparable evaluation of the risks and costs associated with the utility self-build option, it will render the competitive proposal under the RFP too expensive for further consideration.

From a cost-recovery standpoint, the debt-like risk of PPAs should not create more financial exposure for the utility customer than the debt and equity risk of utility-sponsored power plants. The reason is that state approval for PPA cost recovery has been generally consistent and certain for the past 20 years. Imposing debt-like risks on PPAs during the competitive bidding process, but not on the utility-sponsored self-build or own option, creates an unfair bias that can mask the true benefits to consumers of the PPA option. Among those benefits is the fact that PPAs provide a measure of protection for utility customers and shareholders alike, because neither party assumes the risk of contract non-performance – that risk is transferred to the PPA sponsor’s owners and shareholders.

It is clear, therefore, that debt equivalency can work against PPAs if the

2 S.B. 26; Public Utilities Amendments; 2005 General Session; State of Utah; Chapter 17: Energy Resource Procurement Act; Section 54-17-303 – Cost Recovery; pp.14-15

competitive option is not allowed to develop in the manner necessary to compete against proposed rate-based generation. Because the competitive PPA option acts as an essential market test for utility "self-build" generation, and because the PPA provides substantial risk protection to consumers, it is critical that competitive supply not be unduly burdened by a practice that is largely viewed from the perspective of a utility's bondholders, not its customers.

NIPPC believes that PacifiCorp's proposed treatment of inferred debt, or debt-equivalency, should only be applied in the context of a comprehensive review of the costs, risks and benefits of all resource options, including the utility's self-build option. Failing this broad review, the section on inferred debt should be stricken from the RFP. The Commission and PacifiCorp's retail customers in Utah may be better served if this issue is resolved in PacifiCorp's next cost-of-capital proceeding when all of the utility's risk determinants and its risk profile will be considered as a whole – in contrast to a "one-off" element such as the impact of a PPA on its capital structure. PPAs and self-build options should be evaluated using the same approach to measure the true risk impact of both on consumers and on the buying utilities' future cash flows and financial position.

However, should the Commission determine to apply debt-equivalency in this proceeding, NIPPC respectfully suggests that it consider adopting one of the three other options outlined above: 1) reduce the risk factor to 10 percent, which is commensurate with Standard & Poors' current thinking on the subject;[3] ~~reduce the risk factor to a more realistic 10 or 20 percent, which more accurately reflects the risk associated with cost recovery, according to the Standard & Poors philosophy;~~ 2) ensure comparable assessment of all risks and costs of both the competitive proposals under the RFP and any proposed PacifiCorp self-build alternative during the bid evaluation process; 3) consider the provision of a return on the PPA "asset" for PacifiCorp, since it will be managing the performance of the contract, similar to what it does for the performance of its own power plants.

The Electric Power Supply Association, the national trade group that represents competitive power suppliers, has produced two documents on debt-equivalency and competitive procurement in the past two years. Many of the points made in these comments reflect the themes outlined in those documents. Both are attached to these comments and are offered as references for the Commission during its deliberations on the PacifiCorp RFP.[4]

3. The RFP requirement that no bid shall have the effect of subjecting PacifiCorp to "Variable Interest Entity" accounting treatment will preclude the participation of bidders who plan to establish special purpose entities to finance and own the candidate power project. This requirement is an unnecessary restriction on RFP participation.

***NIPPC Comments**:* The RFP requirement that proposals not result in VIE accounting and tax treatment will unnecessarily exclude proposals that use project finance structures. Whether VIE consolidation is good, bad or neutral to a purchasing utility depends upon the capital structure and projected earnings profile of the special purpose entity. It is simply arbitrary and unnecessary to exclude all special purpose

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[3] Electric Utility Resource Planning: The Role of Competitive Procurement and Debt Equivalency; p. 35.
[4] Ibid; "Getting the Best Deal for Electric Utility Customers—A Concise Guidebook for the Design, Implementation and Monitoring of Competitive Power Supply Solicitations; Boston Pacific Company, Inc. for the Electric Power Supply Association; January 2004.

entities that could be classified as a variable interest entity under the evolving interpretations of FASB Interpretation No. 46.

Rather than excluding VIEs, Utah Power's customers would be better served if VIEs can be considered in the RFP process and any adverse cost effects of VIE treatment, after considering the capital structure and projected earnings profile of the VIE, can be taken into account alongside the overall costs and benefits of self-build options and other proposals. This is similar to the approach advocated above with respect to "inferred debt."

4. It is unrealistic to expect RFP participants to keep their bid prices open between December 2005 and March 2007, without any opportunity to react to changing market and business conditions.

NIPPC Comments: By forcing RFP respondents to keep their bids open until March 2007, without any consideration to the changes in the wholesale marketplace that will occur between December 2005, when the bids are due, and March 2007, PacifiCorp is exposing the respondents to an unreasonable level of risk that it would never place on itself. The Commission should require PacifiCorp to allow the respondents some measure of flexibility to adjust their PPA contract terms to accommodate market changes during the period in question.

Conclusion

NIPPC appreciates the fact that PacifiCorp and the Commission have embarked on an RFP process that has the potential to diversify PacifiCorp's supply portfolio, reduce risks and costs to the utility's retail customers and provide an objective comparison for any proposed utility-sponsored power projects. However, as discussed herein, there are several areas in the RFP that will likely serve to eliminate a significant amount of otherwise suitable participants, thereby driving the process to a default solution of the utility's own self-build option (which carries its own risks for consumers). NIPPC respectfully recommends that the Commission disapprove the RFP in its current form, resolve the inequities described ~~in these comments~~above and direct that PacifiCorp adopt the specific remedies outlined in these comments.

NIPPC appreciates the opportunity to participate in the RFP process and looks forward to a successful conclusion.

Dated this 24th day of August, 2005.

Respectfully submitted,

NORTHWEST INDEPENDENT POWER PRODUCERS COALITION

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CERTIFICATE OF SERVICE

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