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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	)))))))	DOCKET NO. 05-035-47 **REPLY COMMENTS OF PACIFICORP**

I. Introduction

In this filing, PacifiCorp (or the "Company") respectfully replies to the comments of the Independent Evaluator (IE), the Committee of Consumer Services (CCS), the Division of Public Utilities (Division), Utah Association of Energy Users (UAE), LS Power Associates, LP (LS Power) and Western Resource Advocates (WRA) on PacifiCorp's draft 2012 RFP.

PacifiCorp welcomes stakeholder feedback on the design of the 2012 RFP and the current draft reflects much of the feedback received to date. PacifiCorp appreciates the parties' recognition of the many design refinements in the 2012 RFP, including the observations that it represents a significant improvement over previous RFPs in terms of transparency, fairness and analytical sophistication. *See* Comments of IE at 23-24 (summarizing major improvements in RFP design); Comments of UAE at 2 (noting that the 2012 RFP constructively responds to stakeholder feedback on RFP 2009).

PacifiCorp also appreciates the many positive comments contained in the IE's assessment of the 2012 RFP, including that the RFP contains a "transparent process that provides the necessary information to bidders on which to base their proposals," and that PacifiCorp's modeling methodologies are "consistent with industry standards" and are unbiased.
IE Comments at 3-5.

PacifiCorp continues to be receptive to new RFP design refinements, and on August 30, 2006, it filed revisions to the 2012 RFP with the Oregon Public Utility Commission to comply with new competitive bidding guidelines. *See In re Investigation Regarding Competitive Bidding*, Order No. 06-446 (Oregon RFP Order). These revisions respond to many of the issues raised in the opening comments in this docket. PacifiCorp has attached an electronic copy of the 2012 RFP filed in Oregon on August 30, 2006, as Exhibit A to these reply comments and refers to this version of the 2012 RFP throughout these comments. Prior to the hearing in this case, PacifiCorp intends to prepare and file another revision to the 2012 RFP to incorporate proposals from this docket not yet reflected in the RFP, such as certain of the specific revisions contained in the IE's Comments at pages 24-27.

Because the parties to this docket raise numerous and overlapping issues, PacifiCorp's reply comments are organized by issue, rather than by party, and focus on the general subjects which received comments from multiple parties.

II. PacifiCorp's Response to 2012 RFP Design Issues.

A. Comparability of Benchmark Options and Market Bids.

The chief concern articulated by the IE is that, given the 2012 RFP's orientation toward large, base load resources and its coal benchmarks, the 2012 RFP will either result in a dearth of market bids or such bids will be competitively disadvantaged unless the RFP recognizes the particular commercial issues associated with a coal-based RFP, as distinguished from an RFP seeking gas resources. Specifically, the IE suggests that bidders be permitted to modify the pro forma contracts in various ways without a reduction in their screening scores, including aligning the PPA more closely with the APSA and indexing certain costs during the development stage. UAE echoes the IE's concerns about the limited pool of bidders for long-term resources and the inflexibility of the pro forma contracts, and the Division reiterates the concern about the RFP's apparent focus on gas resources, instead of coal resources that compare more closely to the proposed benchmarks.

PacifiCorp has five responses to these concerns. First, the IE's Comments incorrectly imply that this is an RFP for coal resources. While the Benchmark Resources for the 2012 RFP are coal resources, the 2012 RFP solicits the market for proposals from eight Eligible Resource categories and two exceptions. These proposals include flexibility of resource type, technology and the ability to build resources to specified criteria on the Company's sites. Revisions to the pro forma contracts specifically designed for coal resources are inconsistent with PacifiCorp seeking bids for a range of different resource types, including coal, gas, geothermal and specific hydro-based resources.

Second, the IE recognizes that both the PPA and the APSA as presently drafted are "within the bounds of industry norms." IE Comments at 5. While the IE does note that the PPA is "tougher on Sellers" than the APSA, PacifiCorp submits that this is appropriate because the PPA is a contract of longer duration and poses greater risk for PacifiCorp.

Third, Oregon's new competitive bidding guidelines provide that a "utility must allow bidders to negotiate mutually agreeable final contract terms that are different from ones in the standard form contracts." Oregon RFP Order at 7, quoting Guideline 6. In compliance with this

Guideline, PacifiCorp has amended the 2012 RFP to expressly permit modifications to the pro forma contracts that benefit or are neutral to the Company and its customers without a screening penalty. *See* 2012 RFP, Section 5(A) at p. 36. Express changes to the pro forma contracts to make them more suitable for coal resources instead of gas resources should generally be neutral or beneficial to PacifiCorp.

Additionally, the 2012 RFP provides that "The Company will allow bidders to negotiate final contract terms that are different from the generic Proforma contracts as long as such negotiated terms constitute contract provisions that are acceptable to PacifiCorp on a legal, contractual, credit and other business basis." *See* 2012 RFP, Section 6 (B) at pp. 40-41. Thus, under the 2012 RFP, a bidder may propose significant changes to the pro forma contracts—including changes to make the PPA more commercially compatible with a coal-based bid—without being penalized in the screening or contract negotiation process, as long as the changes do not harm PacifiCorp or its customers.

The IE suggests that comparability between the Benchmark Resources and third-party bids requires PacifiCorp to allow bidders to comprehensively index costs in their bids, beyond fuel costs. Because this would constitute a contract change designed to shift risk to customers, it would not fall within the contract modification provision PacifiCorp has added to the 2012 RFP allowing only customer-neutral or beneficial changes. PacifiCorp has several comments about this proposal. First, to the extent that it increases generation costs and risks to customers, it is contrary to the underlying goals of the 2012 RFP and PacifiCorp's IRP. Next, absolute comparability between the Benchmark Resources and third-party bids is impossible, given the inherent differences between the two types of resource proposals. The fairness of the RFP can still be assured, however, through the presence of the IE and the other features designed to ensure transparency and objectivity in the bid evaluation process. Finally, while the IE's suggestion for indexing is creative and provocative, the proposal does not take into account the traditional regulatory principles to which PacifiCorp is subject. Because these principles would not permit PacifiCorp to achieve regulatory approval for multi-million dollar generation projects with comprehensively indexed and undefined costs, it is not appropriate to solicit bids of this nature in this RFP.

Fourth, Oregon's competitive bidding guidelines require the IE to evaluate third-party bids and benchmark resources on a comparable basis, and specifically direct the IE to "evaluate the unique risks and advantages associated with the Benchmark Resource (if used), including the regulatory treatment of costs or benefits related to the actual construction and plant operation differing from what was projected for the RFP." Oregon RFP Order at 12, quoting Guideline 10(d). PacifiCorp has amended the 2012 RFP to comply with this requirement. *See* 2012 RFP, Attachment 4 at p. 147.

Additionally, in compliance with Oregon RFP Guideline 8, PacifiCorp has amended the RFP to require that the Company provide the IE and the Oregon Commission with a detailed evaluation of each benchmark resource, including supporting cost information, before bids are received. *See* 2012 RFP, Section 1(A) at p. 2. This amendment also addresses the specific concerns raised by the Division on the IPP3 benchmark, because the evaluation will contain the background data on the IPP3 resource requested by the Division. Division Comments at 5. While some of the information contained in the benchmark evaluation is confidential, PacifiCorp believes that arrangements can be made to ensure that the Division has access to this evaluation after the Company locks down the Benchmark Resources.

Furthermore, in response to the IE's suggestion to separate the benchmark team and the bid evaluation team, PacifiCorp has added an internal code of conduct to the 2012 RFP. *See* 2012 RFP, Attachment 20. This code of conduct does not currently include a provision prohibiting the bid evaluation team from relying on the benchmark team for technical assistance during the RFP process. PacifiCorp understands that the IE's suggestion for more clear separation of the benchmark and evaluation teams contemplates such a provision to ensure the integrity of potential updates to the Benchmark Resources. *See* IE Comments at 96-101. PacifiCorp agrees to revise its internal code of conduct accordingly, recognizing that it will likely require PacifiCorp to hire outside consultants and increase the overall cost of this RFP. Additionally, PacifiCorp understands that the IE would like the Code of Conduct to require the IE's presence at every conversation between the Company and bidders, even after the final shortlist is derived. *Id*. PacifiCorp is willing to add this provision to the Code of Conduct also, subject to a reasonableness standard designed to prevent this provision from impeding the RFP schedule.

Each of these amendments are designed to produce a level playing field for third-party bids and benchmark resources, which addresses the fundamental concern raised by the IE and UAE in their comments on comparability.

Fifth, responding to the suggestions of the IE, the Division and UAE, PacifiCorp has made certain changes to the pro forma contracts to make them less gas-oriented and more resource neutral. *See*, *e.g.*, 2012 RFP, Attachments 3, 5 and 6 (accepting all of IE's comments on APSA; amending PPA provisions on force majeure, development risk, delay damages, unavailability and replacement power, lenders' rights and consequential damages; amending tolling service agreement in similar manner.)

B. Encouraging Flexible Options in Third-Party Bids.

Again in response to the 2012 RFP's call for large, base load resources, the IE suggests that PacifiCorp invite flexible bids, including bids with options for project delay, acceleration or abandonment.

As the IE notes, PacifiCorp included a request in the 2012 RFP for flexibility options in response to an earlier suggestion from the IE. IE Comments at 36-37. The IE submits, however, that PacifiCorp needs to further "enhance" this language to encourage bidders to make such proposals. *Id.* PacifiCorp does not object to this suggestion and will incorporate language in response to this proposal into the next round of revisions.

While PacifiCorp agrees that flexible options are appropriate in the context of the 2012 RFP, it does not agree with the related suggestion of WRA and UAE that PacifiCorp should solicit "bridge" or shorter-term resources. The 2012 RFP is a solicitation for long-term resources with long construction lead times. As the IE recognizes, the Company is not likely to receive any competitive short-term bids in this RFP for the 2012-2014 timeframe. *See* IE Comments at 37. If the Company concludes that the acquisition of short-to-medium term resources is appropriate, the Company can obtain these resources more effectively and efficiently outside of the 2012 RFP.

C. PacifiCorp's Approach to Assessing Potential Carbon Costs.

The 2012 RFP imputes CO2 costs to all coal bids at the $8/ton level currently reflected in PacifiCorp's IRP during the initial short list analysis. During the final short list analysis, the portfolios will be stressed using CO2 scenarios consistent with the IRP. WRA argues that this carbon adder should be increased to better capture the magnitude of climate change risk. WRA Comments at 12-13. On the other hand, UAE argues against automatic imputation of these costs, suggesting that bidders should be permitted to assume this liability. UAE Comments at 11.

In the 2012 RFP, PacifiCorp proposes to follow its IRP approach to assessing carbon risk. PacifiCorp submits that this approach, which WRA has referred to as "robust" in its comments, fairly captures carbon risk in evaluating bids. WRA Comments at 11 ("PacifiCorp's IRP includes a robust scenario analyses of various portfolio alternatives at various levels of CO2 emissions costs.")

PacifiCorp's uniform approach to CO2 imputation is informed by its experience in earlier RFPs where bidders assumed significant transaction costs or risks in the initial bids and later qualified these assumptions and ended up not being willing to bear the full risks and costs. As the IE notes, because of the uncertainty around bidder performance in assuming carbon costs and risks, imputing costs is the preferred solution to ensure fairness in the evaluation of bids. IE Comments at 50.

D. Need for Greater Understanding of PacifiCorp's Proposed Credit Matrix.

The IE, the Division, UAE and LS Power all raise concerns about PacifiCorp's approach to evaluating bidders' credit. In August, PacifiCorp distributed a matrix that contained its proposed credit requirements for bidders. PacifiCorp included its credit matrix in the 2012 RFP at Appendix B, pp. 51-60. This matrix was developed in response to stakeholder requests for flexibility on the level and type of security required and transparency in the credit evaluation process.

While the IE has recognized that the credit matrix may be a "potentially effective approach" to credit evaluation, the IE and other commenting parties seek more information on the methodology used for developing the values in the credit matrix. IE Comments at 45-47.

The IE specifically suggests that PacifiCorp convene a workshop with stakeholders and potential bidders to explain the Company's approach to credit issues and solicit comments.

PacifiCorp appreciates the importance of credit issues to the 2012 RFP and the Company has scheduled the workshop suggested by the IE for September 21, 2006. PacifiCorp proposes to more specifically address the parties' questions and concerns about credit at this workshop.

E. Consideration of Imputed Debt in PPA Bid Evaluation.

The Division, UAE and LS Power all raise concerns about the proposal in the 2012 RFP to consider imputed debt associated with new PPAs. The Division and UAE specifically question the consideration of imputed debt based upon the Utah Commission's Order in *In re Application of PacifiCorp for Approval of an IRP-Based Avoided Cost Methodology for QF Projects Larger than One Megawatt,* Report and Order, at 25-28, Docket No. 03-035-14 (Oct 31, 2005) (QF Order). While noting these concerns, the IE observed that PacifiCorp's process for assessing the impacts of PPA accounting treatment was fair and transparent. IE Comments at 47.

The QF Order does not preclude consideration of imputed debt in evaluating bids in the 2012 RFP. While the Commission refused to permit QF payments to be reduced by the costs associated with imputed debt, virtually all of the evidence in the QF case addressed the debt imputation issue specifically in the QF context and did not address the issue generally or in the context of large PPAs for base load resources. *See, e.g.*, QF Order at 26-28 (arguments that debt imputation could be a barrier to QF development, has not previously been applied by other states in the QF context, is inapplicable to small contracts, contracts mandated by statute or wind contracts designed to avoid fixed charges). The QF Order, therefore, does not control the issue with respect to the 2012 RFP.

The Division endorses the approach to this issue adopted in the Oregon RFP Order. Division Comments at 3, citing Oregon RFP Order at 11-12. Specifically, the Division agrees with the Oregon Commission that: (1) debt imputation should not be used in developing the initial short list; and (2) upon request, the Company could be required to seek an opinion from a ratings agency to substantiate a debt imputation claim in evaluating the bids for the final short list.

In its recent revisions to the 2012 RFP, PacifiCorp incorporated the approach of the Division and the Oregon Commission to debt imputation, eliminating it as a consideration in compiling the initial short list. *See* 2012 RFP, Section 5. PacifiCorp submits that this approach is a fair resolution of the competing concerns presented by this issue.

F. RFP/IRP Linkage.

Both WRA and UAE question whether the 2012 RFP is sufficiently tied to PacifiCorp's most recent IRP. WRA questions the 2013 resource as one not previously studied in an IRP and argues against the proposed replacement of 700 MW of front office transactions with a coal plant without IRP review. WRA Comments at 20. UAE questions whether the resource need reflected in the 2012 RFP has been fully vetted in the IRP. UAE Comments at 4.

The comments submitted by the CCS respond to these contentions. CCS notes that the RFP presents a similar but not identical portfolio to the preferred portfolio identified in PacifiCorp's 2004 IRP update by adding a portion of an additional coal plant as a benchmark in 2012, moving forward and increasing the size of the Bridger benchmark, and including a new IGCC benchmark. CCS Comments at 2. As CCS explains, the major changes in the portfolio are an increase in size, reflecting the proposed replacement of front-office transactions with long-term resources, and the addition of an IGCC plant. CCS supports the increase in size of the RFP as one that is consistent with a desire to "firm [PacifiCorp's] requirements with stably priced power as soon as possible," and "reduce market and gas price risk." *Id*.

With respect to the resource need reflected in the RFP, and more specifically the 15% reserve margin, the Utah Commission's Order on IRP 2004 acknowledged the IRP but based upon the passage of SB 26, not the IRP Action Plan. *In re Acknowledgment of PacifiCorp's IRP 2004*, Report and Order, Docket No. 05-2035-01 (July 21, 2005). Contrary to UAE's assertion, the Commission's Order on the IRP reflects support of the Company's planning metrics and its conclusions on resource needs. *Id.* at 17 ("We conclude that PacifiCorp's IRP is generally consistent with our Guidelines and acknowledge such.")

The 2012 RFP is designed to accomplish the goals of PacifiCorp's 2004 IRP and fill the resource needs identified. In the 2004 IRP, the Company projected a need for 1,780 MW of new large thermal resources on the east-side of the company's system by 2014. This was in addition to 700 megawatts of short-term market purchases. With the passage of time, this need has remained generally constant, except that PacifiCorp is now evaluating whether short-term market purchases are an appropriate resource to meet these projected resource needs because of increasing market prices and uncertainty associated with reliance on short-term markets to meet long-term needs.

Additionally, PacifiCorp is using the 2006 IRP analysis and modeling process for the 2012 RFP. The portfolio modeling and decision criteria used to select the final shortlist of bids will be consistent with the modeling and decision criteria used to develop PacifiCorp's 2006 IRP Action Plan. The sources of input data used in the models to evaluate the bids and the Company's benchmarks, to be updated to reflect current conditions, are consistent with those used in the IRP. The 2012 RFP is fully aligned with the Company's IRP.

G. Allowing Alternative Bids Under the Same Bid Fee.

Both the IE and UAE raise concerns about bid fees deterring alternative or creative proposals. The IE suggests that PacifiCorp allow bidders to offer alternatives on in-service dates and resource size under the same bid fee. IE Comments at 6. UAE suggests that all alternatives be covered by one bid fee. UAE Comments at 9.

Responding to these concerns, PacifiCorp has amended the 2012 RFP to allow bidders to provide a base bid and two alternatives under one bid fee as long as the same resource is involved. As suggested by the IE, these alternatives may consist of a different term or resource size. *See* 2012 RFP, Section 2(F).

III. Conclusion

For all of the foregoing reasons, PacifiCorp respectfully requests approval of the 2012 RFP.

Respectfully submitted this 14th day of September, 2006.

PACIFICORP

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CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of September, 2006, I caused to be e-mailed a true and correct copy of the foregoing **Response Comments of PacifiCorp**, to:

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