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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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In the Matter of the Application of PacifiCorp for Approval of a Request for Proposals for a Flexible Resource	<u>DOCKET NO. 05-035-47</u>  <b>POSITION STATEMENT OF THE UTAH ASSOCIATION OF ENERGY USERS ON PACIFICORP'S DRAFT RFP</b>
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The Utah Association of Energy Users (“UAE”) submits the following position statement on PacifiCorp’s revised draft RFP dated October 27, 2006<sup>1</sup> (“RFP”). Attached hereto is a copy of the October 27, 2006 version of the RFP with certain comments from UAE and certain proposed changes shown in redline format.

**Executive Summary**

Lengthy and useful settlement discussions have led to the resolution of most of UAE’s major concerns with respect to PacifiCorp’s proposed RFP. The input and assistance of the

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<sup>1</sup> UAE understands that PacifiCorp intends to circulate another revised draft RFP by the end of the day (November 1). Unfortunately, UAE will not be in a position to provide comments about or propose redlined changes against that draft because it has not received it in time to do so before to the Friday hearing in this matter. Accordingly, UAE’s comments and redlined changes are directed to the October 27, 2006 draft. To the extent PacifiCorp’s November 1 draft adopts UAE’s proposed changes or

Independent Evaluator (IE) has been indispensable in this process. However, a few major concerns must be resolved properly if the process is to lead to a healthy diversity of competing resource portfolios for the utility and this Commission to consider.

UAE has no inherent bias in favor of utility-built resources (benchmarks) or bids from others (bids). However, it is both a statutory requirement and a critical component of fairness to PacifiCorp ratepayers that benchmarks and bids be evaluated on a fair and comparable basis. The proposed RFP does not yet satisfy this requirement. The IE has provided detailed recommendations and repeated requests for changes to address the comparability issue, with limited success. If these changes are not adopted and the Company succeeds in treating its benchmarks preferentially to bids, the result will be, once again, a pre-determined bias in favor of the Company's benchmarks and an unfair solicitation/evaluation process.

Other remaining UAE concerns deal with the language on debt imputation, credit, operation and maintenance obligations, load curtailment, and miscellaneous other issues which are addressed below and/or in the attached redlined RFP.

***I. Comparability of Bids and Benchmarks.***

Utah's Energy Resource Procurement Act, U.C.A. §§ 54-17-101, et seq. (Act), allows the Commission to approve PacifiCorp's proposed solicitation and solicitation process if they comply with the requirements of the Act and applicable rules and if they are in the public interest. The Commission is directed to suggest necessary modifications to the proposed

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adequately addresses UAE's concerns in certain areas, those issues will not need to be addressed at the hearing.

solicitation or solicitation process to ensure that the public interest is protected. (U.C.A. §§ 54-17-201 (2)(a), (e), (f)).

An issue that is critical to satisfying the public interest is ensuring comparability to the greatest extent practicable in the evaluation of benchmarks and bids. This standard is emphasized in the draft rules: “**All bids must be considered and evaluated against the Benchmark Option on a fair and comparable basis.**” (Draft Rule for §54-17-202, (8)(h) (emphasis added)). Similarly: “All aspects of a Solicitation and Solicitation Process must be fair reasonable and in the public interest.” (Draft Rule for §54-17-202, (1)(a)(a)).

There are a number of significant inherent differences in the nature of benefits and risks faced by ratepayers with a benchmark resource, on the one hand, as opposed to a bid, on the other hand. Some of these differences favor the benchmark. For example, one benefit of a benchmark resource is that ratepayers may benefit from the value of a fully-depreciated plant at the end of its assumed useful life, if it retains value. Also, the benchmark may arguably pose a lower risk to ratepayers of bankruptcy or default over time. On the other hand, a number of risk factors are higher with a benchmark as opposed to a bid. A bidder, for example, will typically be required to assume several significant risks that otherwise would be borne by ratepayers with a benchmark. Among these risks faced by ratepayers with a benchmark are construction cost overruns, project delays, increased cost of capital, increased operation and maintenance costs, catastrophic failures, tax increases, etc. PacifiCorp’s proposed RFP is very aggressive (sometimes too aggressive) in identifying and quantifying risks of bids (e.g., credit, debt imputation). However, the proposed

RFP fails to show similar aggression in identifying and quantifying increased risks of the benchmark options.

Given these significant differences in benefits and risks, bids and benchmarks cannot be evaluated against each other on a “fair and comparable basis” as required by Utah law unless something is done to recognize or reduce the significance of these differences. Perhaps the best option, at least from a theoretical basis, is to assign values to each significant difference and incorporate the values in the formal evaluation process. Despite the theoretical appeal of this approach, UAE has been told that the practical difficulty of developing and assigning reasonable values makes this option impracticable. UAE does not know if that objection is valid, but to date no one has proposed a means for accomplishing the same. Accordingly, UAE assumes that this option is not practicable for purposes of this RFP.

Another option, favored by the IE, is to recognize, but not assign, values to these differences but also, critically, to attempt to reduce these differences to the extent practicable. For example one very significant difference is the risk of increased construction costs after submission of bids but before formal contract execution. For the benchmarks, PacifiCorp will estimate the cost (without the benefit of a binding Engineering, Procurement and Construction (EPC) Contract) and submit its estimates to the IE. PacifiCorp has the luxury of using reasonable or conservative cost estimates for its benchmarks. If the benchmarks are selected but costs increase significantly from PacifiCorp’s estimates in the 15 or 20 months before formal EPC contracts for the benchmarks are executed, PacifiCorp has every right to, and undoubtedly will, seek Commission approval to recover the increased costs. In contrast, a bidder is required to

stand behind its bid for that entire 15-20 month period. Bidders thus do not have the luxury of using conservative, or even reasonable, cost projections. Given the current environment of wild fluctuations in the cost of equipment, materials, etc., a prudent bidder must assume significant increases in at least some of the major cost components in order to protect itself. This will necessarily drive the estimated costs of bids up significantly when compared to benchmarks, virtually assuring that the benchmarks will prevail in the cost evaluation process.

In an effort to address this lack of comparability, the IE has suggested several options. One option is to permit bidders to index a portion of their fixed capacity costs to a recognized index - thus permitting bidders to use more reasonable cost estimates like the utility. Another option is to permit bidders to submit two cost estimates, one a “not to exceed” bid (as required by PacifiCorp’s current version of the RFP) and one based on a 95% confidence level. Both estimates could then be evaluated, or an average of the two could be used. Yet another option would be to require PacifiCorp to submit a “not-to-exceed” benchmark cost estimate that it will be required to live with, like bidders.

In response to these concerns, PacifiCorp tends to confuse the issue by pointing to differences that may be relevant to PacifiCorp between a cost of service and a market based entity (e.g., regulatory lag versus market lag, cost-plus versus market operations, opportunities for additional capital recovery, cost recovery through rates versus through contracts and other regulated versus market differences). Most of these differences are not relevant to the inherent differences in risks and benefits from a ratepayer perspective. PacifiCorp then declares, without

any supporting analysis, that these differences simply offset each other and will be ignored.<sup>2</sup>

This kind of “head in the sand” approach is unacceptable and inconsistent with the requirements of the Act, and will inevitably lead to a strong bias in the evaluation process in favor of the benchmark options.

The Committee, while apparently recognizing inherent differences in benefits and risks between benchmarks and bids, declares that these differences cannot be reconciled and opposes the IE’s efforts to increase comparability for evaluation purposes based on a misguided and erroneous belief that ratepayer risks will increase as a result of the IE’s suggestions. In reality, ignoring the IE’s recommendations will simply ensure that the Company’s benchmarks will artificially win the evaluation without any reasonable or meaningful market check of the Company’s proposed costs.

UAE urgently asks the Commission to require incorporation of one or more of the IE’s suggestions to reduce the lack of comparability between benchmarks and bids before approving an RFP. Certain wording changes, based on suggestions from the IE, are reflected in the attached redline RFP (page 25). Failure to adopt appropriate changes will almost certainly predispose the outcome and make a continued mockery out of PacifiCorp’s RFP process.

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<sup>2</sup> The utility’s unsupported assumption that the risks simply offset each other is not only unsupported and counterintuitive, but also inconsistent with market realities. It is widely accepted that competitive bidders will require a higher return on equity than an incumbent utility in light of the higher risks faced by bidders. Benchmark resources constructed on a cost-of-service basis require a lower return because many of the risks have been assumed by the utility’s ratepayers. A market participant’s higher expected return will be implicit in its bid, thus increasing its cost. In order for the evaluation process to be fair and reasonable from a ratepayer perspective, that portion of the “risk premium” borne by ratepayers with a benchmark (particularly given pre-approval of cost recovery) must be recognized and addressed in some manner.

## ***II. Debt Imputation***

In light of strong objections expressed by many participants, PacifiCorp agreed to remove its calculation of projected “costs” of direct and inferred debt from its initial and final screening processes. Nevertheless, PacifiCorp’s revised draft RFP continues to include PacifiCorp’s proposed calculation of such “costs” and warns that they will be considered in the final selection process. UAE agrees that any legitimate cost impacts should be evaluated in the final selection and approval process, but it strongly disagrees with PacifiCorp’s proposed calculation and urges removal of any references to that calculation in the RFP. Such references will serve no purpose but to discourage bids.

The reasoning and import of the Commission’s ruling on imputed costs in the QF docket squarely apply in this RFP context. PacifiCorp’s proposed debt imputation calculations go far beyond those used by most utilities in the country and would impose unfair and unreasonable requirements on PPA bidders. PacifiCorp uses the highest possible value in the S&P range in its calculation, resulting in the most aggressive possible calculation, despite the lack of evidence that its credit rating (or that of any other utility) has been negatively impacted by a PPA. It is not adequate for the utility to acknowledge that it will be required to justify its imputation of debt costs. The RFP should inform bidders that the utility may consider such impacts in its final selections, but will be required to bear the burden of establishing the same to the Commission. Wording changes to that effect are reflected in the attached redlined RFP (pages 31-33).

### ***III. Credit Requirements.***

UAE still has concerns over the stringent credit requirements specified in the RFP. While the RFP provides a good explanation of the process for calculating credit requirements for a bidder, it does not provide sufficient justification for the level of credit required. Moreover, all non-investment grade entities are lumped into one category, whereas credit risks involving such entities can vary significantly. UAE does not believe that the proposed credit requirements adopt the proper balance between the dual objectives of broad RFP participation and avoidance of unreasonable ratepayer risk. At a minimum, the RFP should permit bidders to propose reasonable and adequate means of ensuring creditworthiness. Wording suggestions to that effect are reflected in the redlined RFP (page 26).

### ***IV. O&M Obligation of Bidders.***

The RFP includes a requirement that an APSA on a bidder's site (category 4), an EPC contract at the Currant Creek site (category 5) or an IGCC project (category 9) will be required to operate and maintain the projects for up to 10 or 12 years. UAE thought that PacifiCorp had agreed to change this requirement to provide that industry-standard performance warranties would be required, which could include an O&M arrangement for a specified period of time. Also, or alternatively, UAE had understood that a term sheet for the proposed O&M obligation would be included so that bidders could understand this potential liability. UAE questions whether the O&M requirement is reasonable or consistent with industry standards, and fears that it might discourage bidding in these categories. Proposed language changes are reflected in the redlined RFP (pages 7-9, 15-16, 19).

**VI. *Load Curtailment and QF.***

The utility should be strongly encouraging customers to implement load curtailment and cogeneration arrangements. Credit and other requirements applicable to third-party bidders should not apply to these customer-based alternatives. Certain wording changes intended to convey the different credit risks faced by customer-based alternatives are reflected in the attached redlined RFP (page 20).

**VII. *Miscellaneous.***

In the attached redlined RFP, a number of other miscellaneous wording changes and edits are proposed, most of which should be largely self-explanatory. In addition, with respect to all of UAE's proposed changes, there may be a necessity of conforming changes to other forms or attachments.

**Conclusion**

Over the past decade, PacifiCorp has without exception selected itself or an affiliate to build or own each new major generating resource. The market has the right to be somewhat skeptical of the bona fides of this RFP process and great care must be taken to convince potentially skeptical market participants that bidders will be treated fairly and will have a competitive chance of being selected. The significant efforts of UAE and others, including this Commission and PacifiCorp, led to the passage of Senate Bill 26, codified at Utah Code §§ 54-17-101, et seq., the hiring of an independent evaluator and significant progress on draft rules to implement SB 26. If implemented properly, these efforts should result in a meaningful and

productive RFP process. The RFP should not be approved by this Commission until both the IE and the Commission can reasonably conclude that the RFP and RFP process are both fair, reasonable, in the public interest, and fully consistent with Utah statutory requirements. UAE urges the Commission to carefully consider the comments of UAE, the IE and other parties in this docket, in order to ensure a fair, open and competitive RFP process.

Dated this \_\_\_ day of November, 2006.

Hatch, James & Dodge

/s/ \_\_\_\_\_  
Gary A. Dodge,  
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was sent by email this \_\_ day of November, 2006, to the following:

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