

***Report of the Independent Evaluator Regarding  
PacifiCorp's 2012 Request for Proposals for Base  
Load Resources***

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buyer.

While PacifiCorp has included a request in its RFP for such flexibility provisions, the IE believes that the language in the RFP should be enhanced to demonstrate the value of such provisions. Furthermore, PacifiCorp may want to include separate schedules or bid forms which provide a “place” in the proposal for bidders to provide such information. In addition, the contract provisions could be modified or identified to reflect these options. As we noted in the first Progress Report of the IE, we could provide information about such flexibility options in other RFPs and techniques for assessing such option value.

## **Bridge Resources**

UAE (and WRA) stresses the value for the Company to actively solicit resource options that will permit it to meet projected needs prior to 2014 on a short-term basis, through “bridging” the reasonably projected resource deficit in the 2012-2013 timeframe. Both UAE and WRA feel the RFP should thus be broadened specifically to solicit shorter-term bridge resources to permit reasonably projected resource deficits to be satisfied, while also permitting a full, timely and adequate analysis of all long-term resource options.

While the concept of “bridge resources” as described by UAE has merit, there are several issues associated with the inclusion of the bridge resources in this RFP. First, due to the long lead-times envisioned for this RFP, it is not likely that bidders will submit proposals for bridge or short-term resources for a potential 2012 contract year in 2006 or 2007. They would prefer to submit proposals far closer to the time the resource is required and the bidder would be in a position to better manage the price risk. Second, if any bidders did submit proposals the price premium would likely be very high. Third, there are other options for meeting the overall objectives of UAE and WRA in combination with the suggestions proposed by the IE for adding flexibility to the bidding process.

For example, if bidders submit proposals with alternative in-service dates, PacifiCorp could issue specific RFPs for short-term or bridge resources and use the results of the RFP to either meet resource needs if it looks like a contracted or selected long-term resource is not meeting its milestone dates in the contract or to use as a tool to determine if it is economical to defer the in-service date of a contracted resource. PacifiCorp could also use its forward curves over time to assess the value of such options relative to the value of potential short-term or bridging resources. In any case, opportunities for soliciting bids for bridge resources will be enhanced the closer to the time of the need for power the utility solicits such resources. Soliciting bids for bridging resources through this 2012 RFP at this time would not likely lead to reasonable bids.

## **Pricing Adjustment Mechanisms For Coal-Based Resources**

Reference is first made to Section 2, Lessons Learned from Coal Based RFPs, of Attachment 1 to Appendix A to this report, the June, 2006 Progress Report of the IE, for a general review of the need for flexible pricing of the capacity payment component of the bidders pricing mechanism or formula. Such an approach not only serves to place a third-party coal project on a more level playing field

with the benchmark coal options but also serves to level the playing field relative to shorter lead-time, less capital intensive technologies, such as gas-fired projects.

As previously noted, given the long lead-times for coal projects, requiring bidders to “lock-in” their capacity price at the time of bid submission and take the cost risk until execution of the EPC contract or later is both an expensive option for the bidder and represents a competitive disadvantage when comparing a third-party bid to a cost of service based self-build option.

In Section V, under the heading, Specific Comments of the IE Regarding the RFP, paragraph 13, the IE has suggested that bidders would be allowed to bid capital cost components which include some indexing options. Some of these component prices for the major risk factor costs would be subject to contractual adjustment clauses which could take a variety of forms. For the development stage, and possibly also for the construction stage, of the contract, certain components might track variable indices such as inflation, a steel index, or a fixed rate of escalation either until the bidder executes its EPC contract, attains financing, or achieves its commercial operation date. The adjustment of other components might be triggered only upon the happening of specific events, such as force majeure events, changes in law or the like. For cost changes with causes outside the control of the bidders, only the actual, demonstrable cost effects of the causes of the change would be reflected in the adjustment. Ideally, the extent of any contractual adjustment clause would be controlled by performance based incentives. For example, component cost “caps”, component cost sharing adjustment mechanisms, and operating incentive mechanism would be encouraged (such as availability bonuses and penalties).

In the IE’s recent experience with coal-based RFPs, one utility allowed such a mechanism to reflect uncertainty in the cost components associated with its project capital costs. Public Service of Oklahoma allowed bidders to either bid a Capacity Cost that was fixed upon the commercial operation date (COD) of the project (much like traditional gas-fired RFPs) and continues throughout the term of the contract. Under this option, bidders could either fix the capacity cost component at a fixed amount for the entire term or include a fixed escalator from the commercial operation date through the term of the contract. The second option allowed the bidder to escalate portions of the capacity charge prior to the COD to arrive at a capacity charge that will be effective as of the COD. Under this option, the bidder may separate the components of the capacity charge and provide a starting value as of the base period date included in the RFP (i.e. June 1, 2006) and escalate those components to the COD at a specified index rate agreed upon by the utility (i.e. steel, inflation, interest rates, etc.). At the COD, the bidder must specify a fixed capacity charge that begins on the COD and continues throughout the contract term of the PPA. Under this option, the bidder may escalate the capacity charge during the contract term of the PPA. However, bidders were not permitted post COD to escalate the capacity charge by an indexed escalation rate during the contract term of the PPA. A sample spreadsheet for this option is attached as Appendix D.

Another approach for attempting to place third-party bids on a more level playing field with benchmark options is to allow bidders and the utility to submit two pricing options: (1) a base project cost if a cost of service option or a base capacity cost pricing mechanism and (2) a pricing mechanism with contingencies that provides for a certain probability of meeting or beating the contingent price, i.e. 95%. Under the second option, the benchmark option and the bidder will

provide the contingency pricing based on assessing the components of its costs are that most variable and uncertain and putting some probabilities around those costs. Bid evaluation could be based on either the contingent cost or a combination of the base and contingent with the final price negotiation targeted to a lower price as the third-party bidder and the utility are able to further develop the project and reduce the cost uncertainty of their project.

## **Economic Evaluation Methodologies and Models**

PacifiCorp will rely on several economic models and methodologies for undertaking the price evaluation of the eligible bids. According to the draft RFP, PacifiCorp indicates that it will utilize a spreadsheet model (“RFP Base Model”) to screen the proposals and to evaluate and determine a short list, and then use a production cost model to determine the final short list and the least-cost/risk resource(s). PacifiCorp provides a description of the RFP Base model inputs in the RFP.

The IE met with the staff at PacifiCorp on two occasions during preparation for the 2009 RFP process to discuss the models to be used for the analysis, the methodologies underlying the economic evaluation of the bids, the development of major inputs to the models (i.e. forward curves for power and gas), and the major assumptions used in the evaluation. The models and methodologies to be used in the 2012 RFP were also discussed during the recent meeting with PacifiCorp on August 9-11, 2006. For each RFP, PacifiCorp has provided the IE a copy of the RFP Base Model to review and evaluate.<sup>14</sup> The IE’s focus with regard to the models is to ensure the modeling approach and assumptions used do not create any undue biases favoring any resource alternative, that the methodologies are consistent with industry standards, and that the methodologies produce consistent results.

While this section of the report will discuss the applications of the models and key findings from our assessment, it is important to note that further testing of the models will take place prior to receipt of bids. The IE proposed, as an optional task in its proposal to the Public Service Commission to serve as Independent Evaluator to develop hypothetical bids to test the modeling methodology and the evaluation system based on the requirements of the RFP.<sup>15</sup> The Public Service Commission approved the optional task and the IE will develop hypothetical bids and test the models and outputs from the model runs based on the bids. The combination of detailed review of the RFP Base Model, the production cost model used for determination of the final short-list, detailed discussions of the major assumptions and inputs and testing of the models using actual data will allow a thorough evaluation of the pricing methodologies by the IE.

For purposes of the evaluation, the quantitative methodologies used will be very important at each stage of the process. As noted, PacifiCorp proposes to use three models for this process: (1) the RFP Base Model which will be applied at the initial screening phase of the evaluation; (2) the Capacity

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<sup>14</sup> PacifiCorp informed the IE that the RFP Base Model has not been revised substantially over the past year, since revisions in preparation for the 2009 RFP in 2005. The IE has noted the changes in the update tab to the model.

<sup>15</sup> The hypothetical or test bid process will attempt to develop bids similar to what third-party bidders may submit. The IE intends to complete all forms and schedules as required for any other bidder. The IE expects to prepare at least two and possibly three test bids including an IGCC option, a pulverized coal option and possibly a gas-fired combined cycle option. The IE will discuss the preferred test bids with the Division Staff.