

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Integrate and Refine
Procurement Policies and Consider Long-Term
Procurement Plans.

Rulemaking 10-05-006
(Filed May 6, 2010)

**OPENING BRIEF OF THE INDEPENDENT ENERGY
PRODUCERS ASSOCIATION**

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SUMMARY OF RECOMMENDATIONS

To improve the bid evaluation and Request for Proposal (RFO) process, the Independent Energy Producers Association respectfully urges the Commission to order the utilities to:

- ffi Define the product sought in an RFO with as much specificity as possible;
- ffi Make available information on the bid evaluation process and bid evaluation parameters to all bidders well before bids are due, and no later than when bid preparation commences;
- ffi Retool the product definitions and the bid evaluation for RFOs to identify the projects that are most likely to achieve operation and to provide the products and characteristics that the utility values most highly;
- ffi Eliminate any caps on independent power producer (IPP) contract terms and give the proposed term of the contract appropriate consideration in bid evaluation;
- ffi Allow existing units that can provide the product sought in an RFOs to bid into the RFO without exclusion;
- ffi Include all of the utility's project and bid development costs in the cost of the utility-owned generation (UOG) proposal for bid evaluation purposes;
- ffi Incorporate the cost of ratepayer risk associated with UOG and IPP projects in the bid evaluation process;
- ffi Use IEP's proposed bid evaluation methodology and algorithm as a model for the utilities' bid evaluations; and
- ffi Provide Energy Division with the data needed to develop adders for cost elements of UOG proposals.

In addition, the Commission should reject Energy Division's proposed restrictions on the utilities' ability to contract with units using once-through cooling.

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In this brief, the Independent Energy Producers Association (IEP) will address two of the Track III issues identified in the *Assigned Commissioner and Administrative Law Judge's Joint Scoping Memo and Ruling*, dated December 3, 2010 (Scoping Memo), and in the *Administrative Law Judge's Ruling Revising System Track I Schedule*, dated March 10, 2011. Most of IEP's brief will address issues related to refinements to bid evaluation in competitive solicitations, particularly with respect to proposals for utility-owned generation (UOG).¹ In addition, IEP will discuss procurement rules for units subject to once-through cooling requirements.²

I. INTRODUCTION: THE NEED FOR REFINEMENTS TO BID EVALUATION

Over the past decade, the Commission has developed two significant policies governing the utilities' procurement of electric generation resources. First, the Commission decided that rigorous *competition* to supply needed resources was in the best interests of

¹ Scoping Memo, p. 44.

² Scoping Memo, pp. 42-43.

ratepayers. Second, the Commission adopted a *hybrid market structure*, in which the need for electric resources could be filled either by UOG or by resources owned or operated by independent power producers (IPPs).

To maximize the benefits of competition for the procurement of resources, a key objective for the Commission and the utilities should be to elicit participation by a large number of bidders that are capable of successfully providing the product the utility is seeking. Past requests for offers (RFOs) have fallen short of this ideal by (1) placing unnecessary restraints on who may bid, (2) failing to fully inform bidders in advance which specific characteristics of the product the utility wants most, and (3) failing to inform bidders of the relative value the utility places on the various characteristics of the desired product. Instead, potential bidders were often left unclear about which resource characteristics the utilities valued most highly or the preferred location of new generation facilities. Furthermore, when UOG projects were proposed consistent with the hybrid market structure, the Commission lacked a clear way to make fair comparisons between a utility proposal and similar resources offered by IPPs.³

This historical approach has also had secondary effects that undermined policy objectives, created administrative inefficiencies, delayed investment, and increased costs to the detriment of ratepayers. When bidding is not disciplined by a complete and transparent definition of the product sought, potential bidders will not fully appreciate, and bids will not reflect, the operational characteristics the utility prefers (*e.g.*, quick start capabilities, fast ramping, downward dispatchability), the locations where the utility forecasts that it needs resources to meet future operational requirements, the ancillary benefits the utility seeks (*e.g.*,

³ Exh. 405, pp. 29-30.

resource adequacy capacity), or the qualitative characteristics the utility values (*e.g.*, environmental benefits, impact on low-income communities).

In addition, even though the utilities might receive a large number of bids in response to their solicitations for vaguely defined products, the conventional approach has some negative indirect consequences that partially offset the ratepayer benefit of having a large number of bidders competing to provide generation resources. For example, when a large number of potential projects are in development out of a belief that they are in the running to supply a poorly defined product, the interconnection queue becomes unwieldy, the utility may need to negotiate with a larger set of shortlisted projects to ensure that it accepts proposals that match the needs that it failed to specify clearly in the RFO, and permitting is delayed at the state and local level as limited staff resources are consumed by projects that may not match the utility's needs. All of these secondary effects result in an unreasonably long lag between the issuance of the RFO and the Commission's approval of the PPA, recently reaching 18-24 months or more as review of the proposals and PPAs is performed by the utility, the procurement review group, the independent evaluator, and the Commission's staff.

These problems suggest a need to refine the procurement process, specifically the elements related to bid evaluation and comparisons of UOG and IPP proposals, the issues that the Scoping Memo posed for resolution in this proceeding. As the Commission considers these issues, it should focus on the following questions:

- ffi How can the utilities' bid evaluation practices be improved to:
 - o minimize the lag between the issuance of the RFO and the Commission's approval of the selected PPAs?

- encourage participation by bidders that are capable of providing the products needed by the utility?
- focus bids and proposals on the utilities' actual needs and the full range of operational, locational, environmental, and financial characteristics the utilities value most?
- elicit bids for and select the projects that are most likely to achieve operation?

ffi How can UOG projects and IPP proposals be compared fairly and accurately?

These are the questions IEP will address in this brief.

II. COMPETITIVE SOLICITATIONS SHOULD USE A TRANSPARENT AND FAIR BID EVALUATION PROCESS TO ENCOURAGE BIDS FROM VIABLE PROJECTS CAPABLE OF PROVIDING THE PRODUCT SOUGHT IN THE RFO

A competitive solicitation should be designed to elicit bids from informed, competent bidders with the financial and technical wherewithal to permit, construct, and operate the projects that they propose in a timely manner if their bids are accepted. California's competitive solicitations, however, have long been haunted by a high failure rate of projects selected by the utility. The California Energy Commission (CEC), for example, calculates that about 30% of the contracts resulting from the annual Renewables Portfolio Standard (RPS) solicitations have been canceled,⁴ and some of the investor-owned utilities (IOUs) have stated that they use an even higher failure rate for planning purposes. These are unacceptably high project failure rates that create significantly higher costs in the form of unnecessary review of

⁴ CEC Staff Report, *Renewable Power in California: Status and Issues*, pp. 6, 45-46.

bids, unnecessary interconnection studies, and displacement and discouragement of viable projects.

One function of the bid evaluation process should be to separate the bids from viable projects that have a higher probability of meeting the utility's needs from the bids from projects that are unlikely to meet the utility's needs or that are unlikely to be developed successfully. The foundation for this screening function is laid if the RFO describes with some specificity the types of products the utility seeks, including a full description of the operational and locational characteristics of the products and how important the individual characteristics are relative to one another. While the project viability calculator is an important tool in the bid evaluation of RPS projects, it is not designed to test whether the project actually meets the needs of the utility. That is the role of the RFO documents: to clearly and completely describe the products the utility is seeking and the characteristics that the utility values most, so that bidders can submit proposals that meet the utility's needs.

The Commission recognized this fundamental principle in its decision in the 2006 Long-Term Procurement Plan (LTPP) proceeding:

[T]he evaluation criteria used in competitive solicitations must be clear, transparent, and available to potential bidders early enough in the procurement process to permit potential bidders to tailor their projects to fit the utility's actual needs... When the utility functions as both buyer and seller, it is particularly critical to ensure that the bid evaluation is fair and transparent. In the absence of a fair and transparent evaluation process, it is unlikely that ratepayers will benefit fully either from competition or from the utilities' participation in a hybrid market.⁵

⁵ D.07-12-052, p. 155. (The Word and pdf versions of this decision posted on the Commission's website have different pagination. All page references in this brief are to the pdf version.)

The continuing high rate of contract failures makes it clear that problems continue in the bid evaluation process. Furthermore, as noted above, the effects of not having clear, fair, and transparent bid evaluation processes extend well beyond a single solicitation. A lack of transparency and a failure to specify the utility's need in terms of product definition and location leads to *speculative bids*. Speculative bids drain the Commission's and utility's limited resources for processing shortlisted bids and negotiated transactions, delay the processing of interconnection requests, and complicate the generation and transmission planning processes (including modeling efforts) required for a rational approach to meeting the demand for electricity and achieving public policy goals, such as the goals for renewable energy or for greenhouse gas emissions reduction.

Despite these repercussions, the RFOs of the IOUs have not always met even the minimum standards of transparency and fairness. Some of the problems with past RFOs and IEP's proposed solutions are discussed in the following sections.

A. To Reduce Contract Failure Rates, Project Viability Must Play a Larger Role in Bid Evaluation

The high percentage of projects selected in competitive RFOs that fail to achieve operation indicates that the existing bid evaluation process undervalues project viability in comparison to other factors. Although the Commission has directed the IOUs to follow a least-cost/best-fit approach to resource procurement, in practice the utilities appear to have overemphasized the least-cost part of this formulation, tending to select the lowest bids without giving sufficient regard to integration costs, congestion, permitting status, environmental effects, the likelihood that the project would be completed, among other considerations. But this approach has it backwards. The utility should first identify the characteristics of resources that would be the best fit for its system, express those characteristics in the specification of the

product to be procured through an RFO, and communicate how it values various characteristics through the weighting of the parameters considered in the bid evaluation. Once the best fit for the utility's system is conveyed through the product identification and the bid evaluation elements, the utility will receive proposals from bidders and develop the short list from the lowest bids from bidders who can provide the best-fit resources and who have a high probability of being able to complete the project.

An emphasis on "least cost" over "best fit" contributes to the lengthy delays that characterize recent procurement efforts. Projects that do not fit the system needs well are bid into the RFO, and as a result, too many projects are proposed that must then be evaluated by the utility, too many projects enter the interconnection queues and require expensive and time-consuming interconnection studies, and too many projects are reviewed by the Commission, only to fail for reasons that should have been detected during the RFO.

The Track III issues listed in the Scoping Memo included, "How failed contracts should be handled within the IOU RFO/procurement process." The best approach to failed contracts is to improve the specification of the products that the utility seeks to procure, to revise bid evaluation to increase the emphasis on project viability, and to greatly reduce the number of failed contracts. IEP respectfully urges the Commission to address this problem by requiring the IOUs to give greater scrutiny to project viability in the bid evaluation process. If the current project viability calculator does not identify the projects that are prime candidates for contract failure, then the project viability calculator (or the application of the project viability calculator) should be revised until it is more effective at identifying the projects that are most likely to fail. But even an improved project viability calculator is just one element of a successful strategy for identifying viable bids. The RFO and bid evaluation processes, if structured appropriately, can be

powerful tools for eliciting submissions from viable projects that meet system need and for identifying least cost-best fit projects that are likely to be completed.

B. The Desired Product or Service Should Be Defined as Specifically as Possible

A minimum requirement for an efficient and effective solicitation is that the product that the utility hopes to obtain through the solicitation should be described as specifically as possible. Put simply, bidders should know what they are bidding for. If bidders are left to guess what products the utility is actually seeking, the result will be a large number of bids that are not tailored to the specific utility needs, leading to extensive negotiations to attempt to conform the proposed projects to meet the utility's needs and delays as well as wasted time for both bidders and bid evaluators. Uncertainty about the product valued by the utility results in higher-priced bids (and higher costs for ratepayers if the bid is accepted) and delays in decisionmaking that erode project viability.

C. Information on the Bid Evaluation Process and Bid Evaluation Parameters Should Be Made Available to Bidders

To improve the quality of proposed project and to allow for the selection of viable projects that meet the utility's needs, significant elements of the bid evaluation process must be more transparent. Bidders need to know not only the product that the utility is seeking, but also the particular characteristics that the utility values most—the best fit for the system's needs. When the specific product definition and the weighting of the desired characteristics are made known to bidders in advance, bidders will provide the projects that meet the utility's needs, resulting in the best value at the lowest cost to ratepayers. As a study of this issue concluded, “both theory and experience from competitive solicitations involving the gas and oil sectors in the energy industry suggests [sic] that additional information about the soliciting entity's views

on the economic value of the product being sought could be helpful in motivating competition amongst the bidders.”⁶

Providing additional information on the utility’s “economic value of the product being sought” enhances competition in two different ways:

If the revelation of “new” information by the utility (the buyer) reduces private information held by certain suppliers, it will encourage more intense competition and increase the expected returns for the buyer (this is known as the publicity effect in auction theory). Moreover, if the buyer’s revelation of information on expected market value of the product being procured is a substitute for the supplier’s pre-existing private information on the value of the product, then it also motivates competition and reduces bidders’ (suppliers’) profits to the benefit of the buyer(s) (this is referred to as the weighting effect).⁷

This is not to say that the utilities should reveal all information related to a solicitation. IEP is not advocating, as some parties have misleadingly suggested, that a utility should tell bidders the highest price it will pay for the product. Instead, utilities should release

their assumptions about underlying drivers, like fuel price outlooks, and supply and demand forecasts. In doing so, they would allow bidders to develop views congruent with the soliciting utilities’ expectations, or at the minimum direct bidders to credible public sources for this information.⁸

Another study of this issue, prepared for the National Association of Regulatory Utility Commissioners (NARUC), similarly concluded that with regard to transmission issues,

[U]tility RFP documents should assist bidders by identifying to the extent possible such things as: any favored delivery points given the existing configuration of loads and generation in the network;

⁶ Frayer, Neeman, and Wittenstein. “Applications of Information Policy Principles from Auction Theory in the Deregulated Electricity Market.” Presented at the 32nd International Association for Energy Economics (IAEE) International Conference in June 2009, pages 3-4, quoted in Exh. 2000, p. 10.

⁷ Frayer, *et al.* p. 6, quoted in Exh. 2000, pp. 10-11.

⁸ Frayer, *et al.* p. 16, quoted in Exh. 2000, p. 11.

locational information about a benchmark resource; or information about likely integration costs.⁹

If simulation models are used in bid evaluation,

[to] the extent possible, utilities should aim to provide bidders with information about input assumptions used in these models, such as demand forecasts and key parameters of other system resources. This will allow suppliers to shape their competitive offers to be more attractive than other offers.¹⁰

Past solicitations have typically provided little of this information. While much of the bid evaluation process remains shrouded in secrecy, the public got a glimpse behind the curtain in Decision (D.) 10-07-045, which discussed bid evaluation in the application of Pacific Gas and Electric Company (PG&E) for approval of the results of its 2008 Long-Term RFO (A.09-09-021). D.10-07-045 revealed that PG&E's evaluation process relied on weightings of bid evaluation criteria that gave little weight to certain criteria and great weight to others, and that some projects with lower aggregate scores were shortlisted while higher-scoring projects were not.¹¹ As described in D.10-07-045,

the weights placed on certain criteria do not fully reflect this Commission's stated priorities. . . . [O]f the eight factors that PG&E weighted to compute its G-score, "environmental leadership" was given 1/25th the weight of PG&E's highest weighted factor and the lowest overall weight of all the factors. PG&E's low weighting of environmental leadership may have been exacerbated by PG&E's inclusion of a broad range of ill-defined activities under this heading (which can produce a uniform cluster of scores), and PG&E's "after the fact" decision to reduce the weight of any scores that clustered together.¹²

⁹ Susan Tierney and Todd Schatzki. "Competitive Procurement of Retail Electricity Supply: Recent Trends in State Policies and Utility Practices." The Analysis Group. July 2008, p. 42, quoted in Exh. 2000, p. 12.

¹⁰ Tierney and Schatzki, p. 29, quoted in Exh. 2000, p. 13.

¹¹ D.10-07-045, pp. 19-20.

¹² D.10-07-045, p. 20.

If PG&E's weightings and preferences had been revealed in advance of the RFO, two types of benefits would have resulted. First, bidders would have been able to prepare bids and plan projects that responded to the products PG&E sought and the preferences expressed or implied in the weighting factors. Second, public exposure of the weighting factors could have added some needed rationality to the bid evaluation process or at least required PG&E to explain its determinations before the RFO commenced and to justify its after-the-fact reduction of certain weightings. Instead, D.10-07-045 found, after the fact, that "PG&E made some decisions in the RFO process for which it provided no explanation or rationale."¹³ This finding appears to confirm that PG&E's bid evaluation process fails to disclose the key information that would enable bidders to provide proposals that meet the utilities' needs.

The specific information that utilities should provide bidders will depend on the product that the RFO seeks and the bid evaluation methodology that the utility uses. As a general rule, utilities should provide the underlying assumptions they will use in the bid evaluation (similar to the Common Value Portfolio for the bundled LTPPs submitted in Track I of this proceeding).¹⁴ If a utility uses production cost modeling as part of its evaluation, as Southern California Edison Company (SCE) and San Diego Gas & Electric Company (SDG&E) currently do, the utility should provide their basic modeling assumptions so that bidders could use those assumptions in their own models to determine the potential projects, locations, or operating characteristics that would be most highly valued by the utility. If a utility uses forward capacity and energy price curves to evaluate bids, as PG&E does, these curves and other underlying assumptions should be provided to bidders.

¹³ D.10-07-045, p. 51 (Finding of Fact No. 6).

¹⁴ Exh. 2000, p. 14.

This approach is consistent with the Commission's observations about the problems with the bid evaluation performed in connection with PG&E's proposed acquisition of the Manzana wind project. In that case, the Commission criticized PG&E's approach because "it uses different forward energy price curves to calculate the net market values of various projects." If the forward price curves PG&E uses for bid evaluation are made available to bidders, the bidders' ability to respond to PG&E's preferences (as indicated in their forward curves) will improve the quality of the bids submitted and the ultimate viability of the proposed projects, and will reduce costs to ratepayers. A secondary benefit is that publishing the forward curves as part of the RFO will ensure that PG&E uses the same inputs and assumptions for the evaluation of all projects.

Some parties may reflexively object that this level of transparency is excessive and will facilitate gaming. Predictably, allusions to bidding behavior in the Biennial Resource Planning Update (BRPU) auction of the 1990s will be made. Some parties may also contend that if the bid evaluation is made transparent, all the bids will be the same. These concerns are misplaced. First, the BRPU auction had multiple problems, and IEP is not suggesting that the Commission should replicate that auction process. Second, the level of transparency IEP proposes is no greater than what is typically available in RFOs conducted by a public entity. The experience of these transparent RFOs demonstrates that transparency is not synonymous with gaming, and not all bids are the same. Third, under the current procurement process, the bids received in the RFO are used to derive a shortlist of projects that are subject to further negotiation with the utility before a PPA is offered. The utility has considerable discretion to reject any bids that are the product of gaming.

To address the many problems that result when bidders are not given enough information about the utility's needs and preferences in the context of an RFO, IEP asks the Commission to direct the utilities to make available to bidder certain key information about the specific products the utility seeks and the relative importance of various attributes of the product so that bidders can more finely design their projects to meet the utility's needs.

D. Existing Units Should Not Be Excluded From RFOs

In D.05-12-022, the Commission observed that “it is unclear to us as to how a utility can tie any of its resource needs to only new or only existing generation types. In fact, a megawatt-hour is a megawatt-hour, and a kilowatt-hour is a kilowatt-hour (green power and Renewables Portfolio Standard issues aside), regardless if it was generated from a ‘new’ or ‘existing’ resource.”¹⁵ Because “exclusion of certain resources will decrease competition and might affect the prices,”¹⁶ the Commission strongly discouraged the practice of barring existing resources from participating in a competitive solicitation:

To the greatest extent possible, the utilities should conduct power solicitations for the specific power products needed to meet their load-serving obligations. The utilities should avoid the exercise of monopsony power through arbitrary segmentations of potential bidders. The utilities should spend much more time signaling their power product needs to the market so as to encourage all qualified bidders to participate.¹⁷

Despite this admonition, some long-term RFOs continue to exclude bids from existing units or limit bids from existing units to contract terms of less than five years.¹⁸

¹⁵ D.05-12-022, p. 15.

¹⁶ D.05-12-022, p. 16.

¹⁷ D.05-12-022, pp. 16-17.

¹⁸ Exh. 2000, pp. 22-23.

The practice of excluding bidders from RFOs confuses two very different types of requirements. A solicitation for Local Resource Adequacy (RA) capacity, for example, can legitimately require bidders to meet certain performance or availability requirements, since qualifying RA capacity has to be available when needed for reliability purposes. A solicitation for Local RA capacity, however, should not set requirements for what technologies or vintages of generating plants can participate, since any resource (including demand response) that can satisfy the performance, availability, and location requirements should have a chance to compete in the RFO.

Restricting RFOs to new or repowered resources, in contrast, promotes a discrimination that is based on vintage, rather than any legitimate performance requirements. If the asserted need is for reliability, the RFO should identify the performance requirements that bidders should be prepared to meet in order to assure the reliable operation of the grid. A plant's ability to meet those requirements is not necessarily dependent on when the plant was built, and any resource that can meet the requirements should be able to bid.

Some may argue that it makes sense to exclude existing resources from bidding in RFOs during times of capacity shortage, to encourage the development of new resources and needed additional capacity. This approach, however, is just another form of discrimination by vintage. If a resource can meet the legitimate operating or performance requirements for the particular product the utility is seeking in an RFO, it should be allowed to bid, regardless of when it first came on line. Of course, it may turn out that certain performance requirements, such as black start or fast ramping, cannot be economically provided by older existing units, but existing units of recent vintage may be able to provide those services economically and even older units may be able to provide those services at competitive prices if modest capital additions

are made.¹⁹ The point is that the utility should not make the *a priori* assumption that no existing units can provide the desired product and based on that assumption bar any bids from existing units. Excluding existing plants from bidding exposes ratepayers to higher costs if the product sought in the RFO can be provided at a lower cost by one of the excluded bidders.

In addition, denying existing units the chance to compete for the business opportunity provided by an RFO could lead to premature retirements of some units. In a well-functioning market, units will retire when there is no longer a way to earn revenues that exceed costs.²⁰ But a plant owner's decision to retire a unit should be informed by market conditions and opportunities, and not dictated by the utility's administrative decisions. Thus, barring existing units from bidding restricts opportunities for these units to earn the revenue that would justify continued operation and may decrease, rather than increase, the available capacity on the system—the opposite of the intended effect. If 500 MW of new resources are added to the system but 600 MW of existing generation retires (for a net capacity reduction of 100 MW) because the existing units are barred from participating in the only remaining opportunity to sell their capacity, there is a net decline in generating capacity, which could erode reliability. Retirements should occur when a unit cannot economically compete with other resources, not because the unit has been artificially prevented from participating in one of the few available market opportunities.

During a time of capacity surplus, as is forecast for the current planning horizon,²¹ barring existing units from bidding deprives ratepayers of the benefits that the capacity surplus makes available. Allowing existing resources to bid into long-term RFOs can (1) enable IOUs to

¹⁹ See Exh. 601, pp. 14-15.

²⁰ Exh. 601, p. 11.

²¹ Exh. 2400, Slide 35.

lock in lower prices for consumers, (2) discourage the development of unneeded excess capacity, and (3) avoid the economic and environmental costs of new development.²²

For these reasons, the Commission should reaffirm that existing units that can offer the products sought in an RFO should be allowed to participate in the RFO without restriction and should order the utilities to allow existing units to participate in their long-term RFOs.

E. The Contract Terms Prescribed in RFOs Should Not Be Discriminatory

In some RFOs, the IOUs have limited the terms of PPAs in a manner that discriminates against IPPs and against existing resources. For example, SCE's 2006 RFO for New Generation and PG&E's 2008 Long-Term RFO both set a maximum contract term of 10 years for new resources and barred existing resources from participating.²³ SDG&E's 2009 RFO for Demand Response and Supply Resources provided a 20-year term for tolling agreements with new resources located within its service territory and a 10-year term for both new and existing resources located outside of its service territory.²⁴

The practice of prescribing different maximum terms depending on the owner or location of a resource creates two types of discrimination. First, as discussed above, setting maximum terms for existing resources that are shorter than those set for new resources discriminates against existing resources, which in turn may decrease competition and increase costs for ratepayers. Second, setting shorter or different maximum terms for IPPs' contracts than for UOG resources discriminates against IPPs and favors UOG resources, because, all else being

²² Exh. 2000, p. 24.

²³ For example, see PG&E All Source Long-Term Request For Offers, issued April 1, 2008, page 12 and SCE New Gen Request For Offers, issued August 14, 2006, p. 9.

²⁴ SDG&E Request for Offers for Demand Response and Supply Resources, June 9, 2009, pp. 2-4.

equal, amortizing the capital costs of a UOG resource over its full useful life²⁵ leads to a lower per-unit cost than for an IPP project that is forced to amortize its capital costs over a shorter period. In later sections of this brief IEP discusses the challenge of comparing resources with different terms of commitment and suggests how resources with different commitment terms can be compared fairly. At this time, it is sufficient to point out that the Commission should ensure that the terms of IPP contracts are not limited unless the period for recovery of UOG costs is limited to the same extent. In addition, any limitations on the terms of contracts with existing resources should also apply to the terms of contracts with new resources. For example, if UOG proposals in a long-term RFO are evaluated over the 30-year life of the plant, IPPs should also be able to propose PPAs of up to 30 years' duration. Alternatively, as DRA proposes, if PPAs are limited to 10 years, the evaluation of the UOG proposal should also assume that the UOG's project costs are amortized over the same period.²⁶

III. THE NEED FOR FAIR COMPARISONS OF UOG PROJECTS AND IPP RESOURCES

A. Background

In the decision in the 2006 LTPP proceeding, the Commission posed and considered a policy question: *“Is it possible to fairly compare UOG and merchant developer bids in RFO bid evaluations?”*²⁷

After first concluding in the proposed decision that “any form of UOG bidding into competitive solicitations [should be disallowed] until a functional, transparent methodology

²⁵ For example, PG&E evaluated the Oakley turnkey proposal on the basis of a 30-year useful life. Exh. 2000, p. 17.

²⁶ Exh. 405, p. 32.

²⁷ D.07-12-052, p. 197 (emphasis added).

for comparing the bids on a level playing field has been established,”²⁸ the Commission in D.07-12-052 was persuaded to “relax for the moment” the proposed restriction on UOG participation in competitive solicitations for certain types of arrangements.²⁹ The Commission also urged the parties to present “well-developed proposals” on a fair method for comparing UOG and IPPs in the 2008 LTPP proceeding.³⁰

Although Phase II of the 2008 LTPP proceeding (R.08-02-007) included the issue of whether and how refinements could be made to the bid evaluation process to ensure fair competition between Pass and UOG bids, no action on Phase II was taken in that proceeding, and this issue was carried over into Track III of the current proceeding.

B. The Existing Procurement Framework Unfairly Favors UOG Proposals

In the hybrid market structure adopted by the Commission, utilities and IPPs are supposed to compete to provide the generation resources needed to meet customers’ needs. Although the Commission has endorsed the principle that UOG and IPP resources should compete head-to-head in competitive solicitations,³¹ the deferral of its consideration of how to actually perform a fair comparative evaluation of UOG and IPP projects has resulted in a procurement framework that favors UOG proposals over comparable IPP projects in several respects.

1. Access to Information

Not surprisingly, the best, most up-to-date information about a utility’s resource needs and the timing and type of those needs resides with the utility.³² Even though the

²⁸ D.07-12-052, p. 206.

²⁹ D.07-12-052, p. 206.

³⁰ D.07-12-052, p. 207.

³¹ *E.g.*, D.04-12-048, p. 139.

³² Exh. 2000, p. 6.

Commission requires utilities to adopt a code of conduct “to prevent sharing of sensitive information between staff involved in developing utility bids and staff who create the bid evaluation criteria and select winning bids,”³³ the utility staff developing UOG projects and bids may still have better access to relevant information than competing IPPs. For example, a member of the UOG development team might hear discussions of operating problems in a certain area and deduce that a plant located in that area might provide higher value than a plant in another location. In this circumstance, the UOG development staff might acquire useful information that could give the UOG project an edge in the RFO and that is not available to IPPs, without in any way violating the code of conduct. In addition, no matter how solid the walls are constructed between the project development staff and the bid evaluation staff, the utilities’ corporate structures require that at least some managers will be able to look over the walls and observe what happens on both sides.

One of the Track III issues posed by the Scoping Memo was, “What measures should be taken to prevent sharing of sensitive information between utility staff involved in developing utility bids and staff who create bid evaluation criteria and that select the winning bids.” While it may be difficult to completely eradicate the advantage that UOGs derive from originating within the utility that is the sponsor of the competitive RFO, IEP’s response to this issue is that the disclosure of information that is relevant to bid evaluation, as discussed above, will help mitigate the effects of the UOG’s greater access to information. Any advantage the staff developing UOG bids may gain from having better information about the bid evaluation criteria will be dissipated if other bidders also have access to the information that is critical to bid evaluation.

³³ D.07-12-052, p. 206.

2. Project Development Costs

One of the more obvious cost advantages that utilities originally had over IPPs was the ability to recover the costs of project development and unsuccessful projects from ratepayers outside of project revenue. Nonutility project sponsors can recover the costs of project development only through sales of electricity generated from their generating facilities; there simply is no other source of revenue to offset these and other costs.³⁴ As the Commission has recognized, fair competition requires that competitors face comparable risks and that successful competitors are those that best manage those risks and costs, not those that are able to draw on ratepayer support to cover development costs. To promote fair competition between UOG projects and IPP projects, the Commission should adopt the simple principle that if an IPP has to recover its project development-related costs out of project revenues (or reduced earnings), so should the utility, and ratepayers should not be required to subsidize those activities.

In the Commission's hybrid market structure, UOG projects are supposed to compete directly and fairly with projects offered by IPPs. If ratepayers subsidize the development of UOG projects while IPPs must bear their own costs of project development, the competition promised under the hybrid market structure will be skewed in favor of UOG projects. There cannot be fair head-to-head competition between IPPs and UOG if nonutility project sponsors must reflect their project development costs in their bids while utilities' corresponding costs are subsidized by ratepayers and not considered in the bid evaluation process.

The Commission recognized these concerns in D.06-05-016:

³⁴ Exh. 2000, p. 25.

. . . we find it necessary to subject SCE to the same cost recovery risks as faced by independent producers. Independent producers' development costs associated with unsuccessful projects are not recoverable from ratepayers. It is a matter of fairness that SCE assume that same risk, if it chooses to participate.³⁵

Three years later, in D.09-03-025, the Commission rejected SCE's request to add \$21 million of research, development, and demonstration costs to the funding of its Project Development Division. The Commission was concerned about "the potential to create an uneven playing field for competitors" and concluded that "'from a policy perspective, we feel it is important that the project development costs for proposed new projects should not be specifically included in rates.'"³⁶

Despite this clear policy statement, the utilities continue to request and receive funds for activities that should fairly be classified as part of project development, such as "executing strategic acquisitions" of renewable energy projects, performing "preliminary due diligence review, preliminary land siting, economic and project feasibility, and interconnection feasibility studies," and conducting "other development activities."³⁷ PG&E estimates that it spends up to \$37 million annually on screening and other initial project development activities,³⁸ and IEP's witness, William Monsen, calculated that PG&E's overhead related to project development totaled about \$8 million per year.³⁹

The Scoping Memo's list of Track III issues included, "How IOU bid development costs would be addressed ('at risk' or ratepayer-guaranteed)." In IEP's view, there is no reason for the Commission to back down from the principle it previously established: Fair

³⁵ D.06-05-016, p. 52.

³⁶ D.09-03-025, p. 42, quoting D.06-05-016, p. 53.

³⁷ Exh. 2000, pp. 25-26.

³⁸ Exh. 2000, p. 26, citing PG&E testimony in A.09-12-005, Exh. 005, p. 6-37.

³⁹ Exh. 2000, p. 27.

competition requires that competitors face comparable risks. To promote fair competition between UOG projects and IPP projects, the Commission should adopt and enforce the simple principle that if an IPP has to recover project development-related costs out of project revenues (or reduced earnings), so should the utility, and ratepayers should not be required to pay for those activities unless and until the Commission grants a Certificate of Public Convenience and Necessity for the UOG project and authorizes recovery of the costs of the project. As DRA put it, “Shareholders, not ratepayers, should shoulder the costs for IOUs to develop a bid or recover costs on failed UOG bids.”⁴⁰

Regardless of whether or not the Commission requires ratepayers to bear project and bid development costs, for bid evaluation purposes the costs of project and bid development must be included in the economic assessment of a UOG project to avoid an undue advantage for UOG projects over IPP proposals.

3. Comparing Projects with Different Commitment Terms

One problem that has persistently confounded the fair comparison of UOG and IPP projects is the fact that recovery of the capital costs of UOGs is typically projected over the full useful life of the project—30 years or more—while recovery of the capital costs of IPP projects is projected over the term of the PPA—usually 10 years or less. To give a simple example of this approach, if a UOG project and an IPP project with a 10-year PPA both cost \$300 to construct, then (assuming straight-line depreciation for simplicity) the annual cost recovery for the UOG project will be \$10 (*i.e.*, $\$300 \div 30$), and the annual cost of the IPP project will be \$30 (*i.e.*, $\$300 \div 10$). On an annual or revenue requirement basis, the IPP project will

⁴⁰ Exh. 405, p. 34.

appear to be three times more expensive than the UOG project, even though the capital costs for the two projects are identical.

In the absence of a more fully developed and clearly articulated policy on UOG-IPP comparisons, the Commission has necessarily struggled with this issue on a case-by-case basis. For example, the problem of comparing UOG proposals with IPP projects was squarely before the Commission when it ruled on PG&E's request to acquire the Manzana wind project. A few quotations from D.11-03-036 illustrate some of the problems arising from the lack of a mature comparison methodology:

PG&E's net market value approach does not provide an apples-to-apples comparison of the Manzana Wind Project to other projects because it uses different forward energy price curves to calculate the net market values of various projects. In our view, net market value calculations should use similar inputs to the extent possible. Therefore, although the Manzana Wind Project receives a high ranking under PG&E's net market value methodology, we cannot determine that it would have the same relative ranking if the same forward curve was used for all projects to which it is compared.⁴¹

* * *

[W]e are not persuaded that assuming a 30-year life to compare Manzana's energy costs against other projects that are amortized over a different time frame is reasonable. Increasing the length of time over which the costs of the project are amortized has the immediate effect of making PG&E's project appear substantially more cost competitive.⁴²

In another proceeding, PG&E's 2008 Long-Term RFO resulted in consideration of a turnkey arrangement, or Purchase and Sale Agreement (PSA), under which PG&E would acquire ownership of a new power plant upon completion of construction. As noted above, the Commission in D.10-07-045 found several problems with PG&E's bid evaluation, including

⁴¹ D.11-03-036, pp. 22-23.

⁴² D.11-03-036, p. 26.

disparities in the weighting of certain criteria, application of “exceptional project-specific information” to eliminate some high-scoring projects, and a lack of clarity about the bid evaluation process.⁴³ In addition, The Utility Reform Network (TURN)—which had access to confidential information—raised concerns about the different terms that were used to compare the turnkey project with PPAs from other bidders:

[T]he 30-year life of the [turnkey] project (compared to 10 years for the PPAs) introduces a much greater level of uncertainty into the analysis of the resource’s levelized value. In addition, traditional ratemaking for a utility-owned rate based project means that the benefits to customers are concentrated in the later years of the asset’s life . . . , when currently unforeseeable circumstances could erode (or maybe even enhance) the value of the project.⁴⁴

The Commission noted but did not directly address TURN’s concerns.

IEP proposes two ways to address this problem. First, as discussed above, the Commission should bar utilities from imposing arbitrary or discriminatory limits on the contract term that IPPs can propose.⁴⁵ If a UOG is evaluated on the basis of its 30-year useful life, IPPs should be allowed to propose PPAs with terms of up to 30 years. If IPP PPAs are limited to 10 years, then UOG projects should be evaluated as if cost recovery is limited to 10 years. Second, in the bid evaluation process, the period of levelization for IPP contracts should be the same as the period of levelization assumed for the UOG project.⁴⁶

⁴³ D.10-07-045, pp. 17-19.

⁴⁴ Opening Brief of The Utility Reform Network, A.09-09-021, April 14, 2010, p. 14, partially quoted in D.10-07-045, p. 37.

⁴⁵ Exh. 2000, p. 18.

⁴⁶ Exh. 2000, p. 21. DRA makes a similar proposal: “Specifically, for assessment purposes, amortize the UOG project costs over the same period that reflect the term of the PPA contracts against which the UOG is being compared.” Exh. 405, p. 32.

4. Accounting for Risk and Uncertainty as Elements of Cost

A reasonable bid evaluation methodology will compare the costs and benefits of a particular proposal. The Commission's least-cost/best-fit approach is an example of this type of comparison, where the potential benefits of a project are measured against its costs and the utility's resource needs. The introduction of UOG projects into an evaluation of resource proposals, however, adds a new dimension to the cost calculation. In a PPA, the cost to ratepayers is typically specified for many cost elements for the duration of the contract. A fixed price for delivered energy, for example, will insulate ratepayers from variations in the costs of operation and maintenance (O&M), project development, overhead, transmission, and other included elements. On the other hand, the costs of UOG projects are usually recovered on a cost-of-service basis, under which ratepayers bear the risk (and potentially the benefits) of cost variation. Ratepayers pay the prudent costs actually incurred for the construction and operation of the plant, regardless of whether they are higher or lower than the initial estimates used to evaluate the UOG proposal. Thus, UOG proposals introduce a degree of ratepayer risk and uncertainty into the evaluation of the actual costs that ratepayers would incur for the UOG project.

To provide a fair comparison between UOG and IPP projects, the calculation of the costs of a project must be expanded to include the uncertainties and risks that the project poses to ratepayers, not just the expected value of the economic costs of constructing and operating the facility.

Risk and uncertainty are key considerations in the development of a methodology for making fair comparisons between UOG proposals and IPP bids. Unless the risks associated with various proposals are identified and carefully weighed, the bid evaluation process could choose projects that ultimately result in much higher costs for ratepayers than other projects in

the solicitation. The study on bid evaluation prepared for NARUC, for example, concluded that a “successful evaluation should attempt to account for these costs and risks, assign weights that appropriately reflect the value proposition (and risks) to customers, make comparable evaluations across all offers (including self-build and affiliate offers), and complete evaluations in a timely and efficient fashion to provide proper incentives for bidders.”⁴⁷

Although both UOG proposals and IPP bids entail some degree of uncertainty and risk, the incremental risks associated with certain UOG projects have not always been explicitly identified and considered in the bid evaluation process. The uncertainties and risks associated with UOG projects can include:

- ffi **Financing risk:** The evaluation should include the incremental cost of issuing new debt and equity to finance construction.⁴⁸
- ffi **Construction risk:** The duration and cost of completing the UOG plant can create uncertainty and additional costs.
- ffi **Performance risk:** If the UOG resource fails to perform as expected, ratepayers will face the cost of replacement capacity and energy. Similarly, if a plant’s heat rate is higher than expected, ratepayers will face the cost of the additional fuel requirement.
- ffi **Fuel price risk:** Ratepayers are typically exposed to uncertainty and risk related to the cost of fuel for the UOG project.
- ffi **O&M risk:** The costs of O&M can vary from initial projections.

⁴⁷ Exh. 2000, p. 31, quoting Tierney and Schatzki, p. 28.

⁴⁸ Exh. 2000, p. 30, quoting Susan Morse and Meg Meal, “Balancing Incentives in a Competitive Marketplace,” *Electricity Journal*, Aug./Sept. 1993, pp. 30-31.

- ffi **Technological risk:** Improvements to existing technologies or the rise of new technologies can render a plant obsolete long before its expected useful life is over.
- ffi **Environmental risk:** Environmental concerns may limit the operation or require early retirement of significant capital additions to the plant.
- ffi **Transmission risk:** Congestion can affect the delivery of energy to customers.

The effect of these uncertainties and risks on ratepayers is a consequence of cost-of-service ratemaking that, with few exceptions, passes on to customers the costs that utilities incur in their generation operations. If utilities' costs of construction, O&M, fuel, and capital additions, to cite a few examples, are not specified and recovery limited to the specified costs at the outset, the eventual cost to ratepayers is subject to considerable uncertainty and risk.⁴⁹

The effect on ratepayers of uncertainty and risk must be accounted for in a fair bid evaluation methodology. If an IPP bid includes O&M costs as part of a fixed price, then it presents no ratepayer risk for that cost element. For a comparable UOG resource under cost-of-service ratemaking, there is some risk—a potential for increased costs—associated with the O&M component. If the two projects are otherwise identical, a bid methodology that ignores risk might select the UOG project, even though there is more risk to ratepayers associated with the UOG option.⁵⁰

In addition to identifying the risks associated with a particular proposal, the bid evaluation should also consider the range of variability and the probabilities of specific outcomes

⁴⁹ Exh. 2000, p. 29.

⁵⁰ See Exh. 2000, p. 33.

within those ranges. IEP recommends that the utilities should identify the potential change in costs for ratepayers for each proposal (both UOG and IPP) over the life of the project's obligation to the utility, and, based on historic variability, establish the range of values and the probabilities of specific values within the range. In that way, each project's risk, uncertainty, and potential cost for ratepayers can be assessed in a systematic fashion.

IV. A FRAMEWORK FOR FAIR BID EVALUATION

Only one party—IEP—presented a full proposal for a refined bid evaluation methodology. IEP offered a detailed illustration, based on available information, of how a bid evaluation algorithm could be used to provide a fair comparison between UOG projects and IPP bids. IEP's proposed algorithm should also be used to compare one PPA offer with another PPA offer, even if no UOG project is involved in the solicitation.

IEP's proposed algorithm should be used to guide the utility in the selection of the shortlist, which should consist of projects totaling at least 200% of the needed capacity and energy the utility sought in the solicitation.⁵¹ Once the shortlist is created, the utility would analyze the shortlisted projects on a portfolio basis and under a wide range of assumptions reflecting uncertainty about variables such as fuel prices, inflation, actual UOG costs and performance relative to bid values, and technological change and should evaluate the revenue requirement per MWh for each portfolio.

As discussed earlier in this brief, the bid evaluation algorithm and the parameters to be considered, the method for quantifying the parameter, the information needed for this quantification, and the weighting factor for each parameter should be disclosed to bidders in

⁵¹ Exh. 2000, p. 46.

advance of the due date for bids. This disclosure would attract the most informed, responsive, and competitive bids and further transparency in the bidding evaluation process.

A. The Algorithm

Under IEP’s proposed approach, key elements of several categories of variables would be quantified and scored to develop comparisons between projects. The categories considered in IEP’s proposed algorithm are net financial benefit, project viability, environmental characteristics,⁵² and other qualitative parameters.

The larger categories would be weighted relative to one another, and the weighted scores added up to arrive at the final score.

In Attachment A to his testimony, Mr. Monsen provided a chart showing how the four larger categories would be weighted to arrive at the final score for a project:

<p>Project Score = 60% * Present Value of Financial Benefit + 25% * Project Viability + 10% * Environmental Characteristics + 5% * Qualitative Parameters</p>
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Ensuring that comparisons between UOG proposals and IPP bids are fair would be accomplished through adders (positive or negative) applied to certain UOG cost elements to reflect the additional risk and uncertainty for ratepayers of UOG projects. The adders used in IEP’s illustration are derived from the best available information, but more refined adders could be developed from more complete data that Energy Division obtains from the utilities or other

⁵² The Division of Ratepayers Advocates (DRA) agrees that the bid evaluation should “explicitly consider the environmental attributes of offers,” and that consideration is part of DRA’s recommended approach to units employing once-through cooling. Exh. 405, p. 27.

sources.⁵³ The resulting bid evaluation tool could be updated periodically to reflect changing circumstances and needs.

1. Net Financial Benefit

The greatest weight should be given to the net financial benefit of the proposal. This category includes an evaluation of the net present value of financial costs, financial benefits, and financial risks of a project. **Financial benefits** include the locational market value of energy by time of delivery, the market value of capacity, the market value of ancillary services, the value of optionality, and any Local RA capacity value the project offers. **Financial costs** include capacity costs, variable and fixed O&M costs, network upgrades and interconnection costs, greenhouse gas emission allowance costs, hedging costs, fuel storage and transportation costs, and project development costs (including overheads). **Financial risks**—which are often overlooked in the valuation of UOG proposals—include operational risks that reduce market values, operational risks that increase costs, risks of congestion and higher transmission costs, risk of higher construction and financing costs, risk of unanticipated capital expenditures, risk of fuel unavailability, and risk of greenhouse gas allowance exposure.⁵⁴

The details of IEP's proposed bid evaluation algorithm are described more fully in Mr. Monsen's testimony. To account for some of the differences in risks presented by UOG projects and the incremental uncertainty in ratepayer costs for UOG project relative to PPAs, Mr. Monsen developed estimates of three adders that would apply to gas-fired UOG project

⁵³ Exh. 2000, p. 40.

⁵⁴ Exh. 2000, pp. 38-39.

proposals.⁵⁵ The adders were based on available historical data on the actual installed cost of UOG projects relative to the cost initially proposed for the projects, changes in heat rates compared to the heat rates initially assumed for the projects, and changes in O&M costs compared to the projects' initial estimates.⁵⁶ Based on these calculations, for purposes of bid evaluation a UOG project's capital costs should be increased by 8%, fixed O&M costs by 83%, and heat rates by 5.5%.⁵⁷ Until better data is developed for these and other parameters, these adders should be used in the evaluation of UOG proposals.

A more refined methodology would include a consideration of other factors for which data were not easily available to IEP:

- ffi Operational risks that reduce market values (availability, longer-than-expected ramp rates, life of project, etc.);
- ffi Fuel price uncertainty;
- ffi Risk of higher transmission costs;
- ffi Risk of unanticipated capital expenditures over the plant's lifetime;
- ffi Price risk from indexed priced offers;
- ffi Risk from fuel availability exposure (mainly with hydro);
- ffi Risk from greenhouse gas cost exposure; and
- ffi Congestion risk.

In his testimony, Mr. Monsen assumed that a PPA bid would internalize the uncertainty of these factors, but if a particular PPA included terms that assigned some of these risks to ratepayers, similar adders would be assigned to the PPA for evaluation purposes to

⁵⁵ Exh. 2000, pp. 39-40. The Track III issues listed in the Scoping Memo include, "The extent to which penalty and reward components are or should be added to UOG bids to make them consistent with IPP bids." The adders proposed by Mr. Monsen are intended to account for the greater risk and uncertainty of UOG costs by reflecting the historic differences between initial estimates of cost elements and the actual costs for UOG plants. However, the adders are not intended to punish or reward the UOG or the sponsoring utility, as the language of the Scoping Memo suggests. Instead, the adders are intended to help make UOG bids "consistent with IPP bids."

⁵⁶ The details of the derivation of the values used for the adders are set forth at Exh. 2000, pp. 41-43.

⁵⁷ Exh. 2000, p. 44.

reflect this increased risk.⁵⁸ The broad principle is, “Projects should be assigned only those adders that are associated with parameters for which ratepayers would bear the risk of unplanned changes in these parameters.”⁵⁹

2. Project Viability

Under IEP’s proposal, the evaluation of the viability of a particular project should be based on the criteria and weightings of the Project Viability Calculator, adopted in D.09-06-018, including any modifications to the project viability calculator the Commission may subsequently make. As shown in the table of weightings, reproduced above, project viability should receive considerable weight, second only to financial benefit in the calculation of the final score for a project. The weight given to project viability reflects the concern that the current bid evaluation methodology has not been effective in screening out those projects that are not likely to achieve operation, as reflected in the high contract failure rates noted by the CEC and the utilities.

3. Environmental Characteristics

The score for the environmental characteristics of a project is based on several elements:

- ffi Cumulative exposure to criteria pollutants within one mile and six miles of the facility;
- ffi Local community outreach plans;
- ffi Quantities and potential costs to the utility and to society associated with project environmental characteristics that were not included in the energy valuation, including environmental costs that have been mitigated using the best-available control technology;
- ffi Whether the project is on a brownfield or a greenfield site; and
- ffi Renewable benefits (when considering renewable projects).

⁵⁸ Exh. 2000, pp. 40-41.

⁵⁹ Exh. 2000, p. 44.

4. Other qualitative parameters

The bid evaluation should also consider other qualitative parameters, such as whether the proposed start date is consistent with the utility's needs or preferences, or the degree to which the proposal shifts costs or risks to ratepayers compared to the terms proposed in the RFO. Consistent with the goal of transparency, these parameters and the way they would be used in bid evaluation should be identified in the RFO so that bids will more closely match the products and characteristics the utility actual needs and values.

5. Calculation of the Final Score

A project's final score would combine its score on individual cost elements, including adders as appropriate, and the weightings assigned to the larger cost categories. Mr. Monsen included a sample calculation for two hypothetical projects in his testimony:

Table 1: Final Project Scoring

	Weight	Example 1	Example 2
PV of Financial Benefit	60%	80	95
Project Viability	25%	75	60
Environmental Characteristics	10%	50	85
Qualitative Parameters	5%	20	95
Final Project Score		73	85

V. ONCE-THROUGH COOLING ISSUES

In an appendix to the *Administrative Law Judge's Ruling Denying Motion for Reconsideration and Motion Regarding Track I Schedule and Addressing Rules Track III Issues*, dated June 10, 2011, Energy Division proposed to limit the duration of any new PPAs with existing plants using once-through cooling (OTC) to one year or less, with certain exceptions.

Energy Division's proposal is misguided and would likely increase ratepayers' costs. The compliance dates that the State Water Resources Control Board has established for

OTC plants extend to 2017 or 2020, and it makes little sense to limit PPAs to one year for facilities that can operate lawfully and within the restrictions adopted by the Board for up to eight more years. Because the capital costs of these units have largely been recovered, they are able to offer capacity and Local RA capacity at attractive prices. Restricting these units' ability to contract for more than one year will reduce available capacity and predictably increase ratepayers' costs.

In addition, the revenues these units might be able to obtain from multi-year PPAs can help support the investment that may enable at least some of the units to comply with new water use requirements before the compliance deadline and to remain in operation beyond the compliance date. DRA notes that Energy Division's proposal "puts the IOUs at a competitive disadvantage against other [load-serving entities]" because the limitation would apply only to the IOUs, and the proposal "provides no benefit to ratepayers."⁶⁰

Energy Division's proposal seems to be a quick reaction to the OTC requirements, and it appears that Energy Division did not completely think through the implications of its recommendation. IEP respectfully urges the Commission to reject Energy Division's proposal and to allow existing units using OTC to enter into PPAs with terms at least up to the unit's compliance date.

VI. CONCLUSION

Nearly four years ago, the Commission offered the following comments on bid evaluation:

The evaluation criteria used in competitive solicitations must be clear, transparent, and available to potential bidders early enough in the procurement process to permit potential bidders to tailor their projects to fit the utility's actual needs. Bid evaluation is

⁶⁰ Exh. 405, p. 27.

currently one of the most opaque steps of the procurement process, and as a result not only do “losing” bidders not know why they lost, but “winning” bidders may similarly not know why they won.

A well-functioning competitive process requires that all bids – including the bids of utility-sponsored projects – are evaluated using criteria that are consistent with the goals of the RFO and in a manner that encourages competition among bidders to meet the objectives of the RFO. When the utility functions as both buyer and seller, it is particularly critical to ensure that the bid evaluation is fair and transparent. In the absence of a fair and transparent evaluation process, it is unlikely that ratepayers will benefit fully either from competition or from the utilities’ participation in a hybrid market.⁶¹

Unfortunately, any improvements to RFOs and the bid evaluation process in the intervening years have not been sufficient to avoid some significant problems. Bidders are still too often left in the dark about what exactly the utility is seeking to procure in an RFO. Utilities are less than transparent about the operational characteristics they give the highest value to. The evaluation of the viability of proposed projects still results in a contract failure rate estimated at 30% or more. UOG projects still benefit from an evaluation approach that understates their ultimate cost to ratepayers.

The current economic downturn provides the Commission with an excellent opportunity to take the needed steps to improve the bid evaluation process. IEP has a strong interest in ensuring that the RFO process is fair and transparent and that IPPs are not treated unfairly when they compete with UOG projects.

For that reason, IEP devoted the bulk of its participation in this proceeding to the bid evaluation issues. IEP’s recommendations on bid evaluation are based on a few key principles:

⁶¹ D.07-12-052, p. 155.

- ffi The products a utility seeks in an RFO should be clearly and specifically defined.
- ffi The parameters and weighting factors used in bid evaluation should reflect the operational characteristics and locations that the utility values most highly.
- ffi Bidders should be informed of the operational characteristics and locations that the utility desires and the weighting factors the utility assigns to these elements so that bidders can plan their project to meet the utility’s “best fit” requirements.
- ffi All projects that can provide the product requested in the RFO should be able to participate, and no restrictions on the participation of existing units in RFOs or on the terms proposed in IPP bids should be allowed.
- ffi Comparisons between UOG projects and IPP proposals must account for the greater risk that cost-of-service ratemaking poses to ratepayers relative to cost elements that are specified in a fixed bid and for differences between the useful life of the UOG and the term of the IPP’s PPA.
- ffi Ratepayer subsidies of the costs of project development and failed UOG projects should be included in the evaluation of the costs of a UOG project.
- ffi Product definition and bid evaluation play a critical role in identifying the projects that are most likely to achieve operation and should be designed to supplement the project viability calculator.

To give substance to these principles, IEP offered a framework for bid evaluation and a specific algorithm for bid comparison that included illustrations of how adders could be

calculated to account for differences between the initial estimated costs of UOG facilities and the actual costs once the facilities are in operation.

To improve the bid evaluation and RFO process, IEP respectfully urges the Commission to order the IOUs to:

- ffi Define the product sought in an RFO with as much specificity as possible;
- ffi Make available information on the bid evaluation process and bid evaluation parameters to all bidders well before bids are due, and no later than when bid preparation commences;
- ffi Retool the product definitions and the bid evaluation for RFOs to identify the projects that are most likely to achieve operation and to provide the products and characteristics that the utility values most highly;
- ffi Eliminate any caps on IPP contract terms and give the proposed term of the contract appropriate consideration in bid evaluation;
- ffi Allow existing units that can provide the product sought in an RFOs to bid into the RFO without exclusion;
- ffi Include all of the utility's project and bid development costs in the cost of the UOG proposal for bid evaluation purposes;
- ffi Incorporate the cost of ratepayer risk associated with UOG and IPP projects in the bid evaluation process;
- ffi Use IEP's proposed bid evaluation methodology and algorithm as a model for the IOUs' bid evaluations; and
- ffi Provide Energy Division with the data needed to develop adders for cost elements of UOG proposals.

In addition, IEP joins many other parties in urging the Commission to reject Energy Division's proposed restrictions on IOUs' ability to contract with units using once-through cooling.

Respectfully submitted this 16th day of September, 2011 at San Francisco, California.

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