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)

REPLY BRIEF OF THE INDEPENDENT ENERGY PRODUCERS ASSOCIATION

INDEPENDENT ENERGY PRODUCERS ASSOCIATION
Steven Kelly, Policy Director
1215 K Street, Suite 900
Sacramento, CA 95814
Telephone: (916) 448-9499
Facsimile: (916) 448-0182
Email: steven@iepa.com

GOODIN, MACBRIDE, SQUERI, DAY & LAMPREY, LLP
Brian T. Cragg
505 Sansome Street, Suite 900
San Francisco, CA 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
Email: bcragg@goodinmacbride.com

Attorneys for the Independent Energy Producers Association

Date: October 3, 2011

TABLE OF CONTENTS

Page

I. THE CONTINUING NEED FOR A METHODOLOGY TO FAIRLY COMPARE UOG PROPOSALS AND IPP BIDS 2

II. COMPETITIVE SOLICITATIONS AND BID EVALUATION: PROBLEMS AND SOLUTIONS 4

- A. Bid Evaluations Should Be Transparent and Fair 4
- B. Comparisons of UOG Projects and IPP Resources Should Be Fair 7
  - 1. Fair Comparisons of Projects with Different Commitment Terms 7
  - 2. IOUs Should Not Recover the Costs of Project Development or Failed Projects from Ratepayers 9
  - 3. Risk and Uncertainty Should be Accounted for as an Element of Cost 11
  - 4. Project Viability Needs Greater Emphasis 13

III. IEP PRESENTS A FAIR, FLEXIBLE, AND TRANSPARENT FRAMEWORK FOR BID EVALUATION 14

IV. THE NEED FOR ADDITIONAL PROCUREMENT MECHANISMS 18

V. CONCLUSION 21

- 1. Utilities should clearly identify the functions or products that they hope to procure, including the attributes that are most important to the utility's resource needs 21
- 2. The importance of certain functions or attributes relative to other functions or attributes should be reflected in the bid evaluation and communicated to potential bidders 21
- 3. When UOG proposals are considered at the same time or in the same RFO as IPP bids, the differences between UOG and IPPs' projects must be accounted for in the bid evaluation: 21
  - a. Different commitment terms must be equalized for bid evaluation purposes 21
  - b. Project development costs must be reflected in the costs used for bid evaluation 21
  - c. The cost of failed bids must not be borne by ratepayers 21
  - d. The risk that the UOG project's eventual costs will exceed its initial cost estimates must be accounted for in the comparison 21
- 4. Project viability must be given greater weight throughout the RFO and bid evaluation process 21

SB_GT&S_0624081

TABLE OF AUTHORITIES

Page(s)

DECISIONS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

Decision 04-01-050 2

Decision 05-08-005 17

Decision 06-05-016 .... 9, 10

Decision 06-09-021 17

Decision 07-11-046 17

Decision 07-12-052 .... 11, 22

Decision 09-01-008 17

Decision 09-03-025 9

Decision 10-07-045 5

Decision 11-03-036 8

OTHER AUTHORITIES

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 .... 6, 17

Susan Tierney and Todd Schatzki. "Competitive Procurement of Retail Electricity Supply: Recent Trends in State Policies and Utility Practices." The Analysis Group. July 2008 7

SB_GT&S_0624082

SUMMARY OF RECOMMENDATIONS

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

- Define the product sought in an RFO with as much specificity as possible;
- 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;
- 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;
- Eliminate any caps on independent power producer (IPP) contract terms and give the proposed term of the contract appropriate consideration in bid evaluation;
- Allow existing units that can provide the product sought in an RFOs to bid into the RFO without exclusion;
- 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;
- Incorporate the cost of ratepayer risk associated with UOG and IPP projects in the bid evaluation process;
- Use IEP's proposed bid evaluation methodology and algorithm as a model for the utilities' bid evaluations; and
- Provide Energy Division with the data needed to develop adders for cost elements of UOG proposals.

In addition, the Commission should (1) adopt Calpine's proposal for intermediate term solicitations to procure flexible resources to support renewables integration or, in the alternative, define a procedural path that will lead to a timely decision on how to fill the gap that Calpine has identified and (2) reject Energy Division's proposed restrictions on the utilities' ability to contract with units using once-through cooling.

2970/024/X132376.v1

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)

REPLY BRIEF OF THE INDEPENDENT ENERGY PRODUCERS ASSOCIATION

The essential message of the Independent Energy Producers Association (IEP) on the Track III bid evaluation issues is, "If you want something, ask for it." IEP's testimony[1] and its Opening Brief addressed how IEP crafted a solution to the problem of reconciling the Commission's policies of (1) using competitive mechanisms to select the electric generation resources needed to meet the needs of the customers of the investor-owned utilities (IOUs) and (2) relying on a hybrid market structure that incorporates both utility-owned generation (UOG) and generation facilities owned and operated by independent power producers (IPPs). IEP explained how the bid evaluation framework developed by its witness, William Monsen, would introduce a needed transparency into the Request for Offers (RFO) and bid evaluation process and would attract focused, high-quality bids, help unclog the interconnection queue at the transmission and distribution level, and reduce the review and approval bottlenecks that currently create a 12-18 month lag between contract execution and the Commission's approval.

[1] Exh. 2000 (IEP/Monsen).

SB_GT&S_0624084

IEP was gratified to see that many other parties shared IEP's concerns about the current state of bid evaluation in RFOs and endorsed at least some of IEP's proposed solutions. Objections to IEP's proposed framework appeared to be grounded either in a willful misunderstanding of IEP's proposal or in an inflexible attachment to the status quo. In this reply brief, IEP will respond to other parties' comments made on IEP's bid evaluation proposal and other issues in this proceeding.

I. THE CONTINUING NEED FOR A METHODOLOGY TO FAIRLY COMPARE UOG PROPOSALS AND IPP BIDS

A tension has long existed between the Commission's dual policies favoring both procurement of generation resources through competitive mechanisms and the hybrid market structure. In Decision (D.) 04-01-050, for example, the Commission decried the fact that "the Commission does not have a comprehensive methodology available at the time to evaluate [utility] projects against alternatives brought to us through a competitive RFP."[2] Over seven years later, the Commission is entertaining proposals for refinements to bid evaluation that will allow for fair comparisons between UOG projects and IPP bids.

Nevertheless, some parties believe that this effort is pointless because they think that the differences between UOG and IPP projects defy comparison. Southern California Edison Company (SCE), for example, asserts without elaboration that UOG and IPPs' bids for power purchase agreements (PPAs) are not comparable during a bid evaluation process.[3] The Western Power Trading Forum (WPTF) is more expansive and more vehement, explaining that such comparisons are impractical due to fundamental differences in duration of the commitment,

---

[2] D.04-01-050, p. 63.

[3] SCE's Opening Brief, p. 31.

SB_GT&S_0624085

risk profiles, and effect on utility earnings.[4] WPTF concludes that UOG proposals should not compete in utility RFOs.[5] Pacific Environment concurs.[6]

If the utilities were to commit without qualification to abstain from proposing any UOG projects for the ten-year planning horizon of this proceeding, then IEP agrees that its proposed refinements to the bid evaluation methodology would not be necessary. However, Pacific Gas and Electric Company (PG&E) and San Diego Gas & Electric Company (SDG&E) have both indicated that they will consider submitting UOG bids in the competitive solicitations for long-term energy and capacity for the 2011 through 2020 planning horizon.[7] Even SCE, which "has not submitted and has no plans to submit UOG bids in its solicitations"[8] and which endorses the principle that "UOG projects should be proposed only when competitive processes cannot deliver the products that the utility needs to serve its customers in a cost-effective manner,"[9] would not rule out pursuing UOG projects.[10]

The reason the Commission needs to continue its effort to refine the bid evaluation process to ensure fair competition between PPAs and UOG bids is that UOG proposals keep coming before it for approval. The Division of Ratepayer Advocates (DRA) identifies no fewer than ten instances in the last five years when utilities have sought the Commission's approval for UOG projects.[11] As DRA pointed out:

> [I]n all cases, the evaluation and comparison of UOG opportunities to market alternatives has been highly contentious and

[4] WPTF's Opening Brief, p. 6.
[5] WPTF's Opening Brief, p. 9.
[6] Pacific Environment's Opening Brief, p. 42.
[7] Exh. 2000, p. 5 (IEP/Monsen).
[8] SCE's Opening Brief, p. 22.
[9] Exh. 211, p. 16 (SCE/ Cushnie).
[10] Exh. 2000, p. 5 (IEP/Monsen).
[11] Exh. 405. p. 29, fn.34 (DRA/Peck).

SB_GT&S_0624086

> problematic. Given this reality, it behooves the Commission and parties to focus our efforts in improving and refining the process rather than ignoring the problems, as PG&E and SDG&E seem to do, or giving up on trying to address them, as WPTF and SCE suggest.[12]

Moreover, even if no UOG proposal is considered in an RFO, the improvements to transparency and bid evaluation IEP recommends will improve the efficiency and effectiveness of the solicitation, to the eventual benefit of ratepayers. The Commission's consideration of improvements to the bid evaluation and RFO process is, if anything, overdue.

II. COMPETITIVE SOLICITATIONS AND BID EVALUATION: PROBLEMS AND SOLUTIONS

In its Opening Brief, IEP explained how problems in the RFO and bid evaluation process have secondary effects that undermine the achievement of policy objectives, create administrative inefficiencies, delay investment, and increase costs for ratepayers. Poorly defined products and an opaque bid evaluation process lead to bids that are not targeted to the desired products, unwieldy interconnection queues, and a lengthy contract review and approval process that ultimately results in higher costs for ratepayers. To address these problems, IEP made several suggestions.

A. Bid Evaluations Should Be Transparent and Fair

A fundamental principle is that 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. Achieving that goal has been frustrated in past solicitations by a lack of clarity about the product being sought and a lack of transparency about how bids would be evaluated. One consequence of this lack of transparency is the high contract failure rate.

[12] DRA's Opening Brief, p. 30.

SB_GT&S_0624087

In its brief, Pacific Environment describes the lack of transparency in bid evaluation of its particular concern, environmental justice. Pacific Environment highlights the Commission's review of the bid evaluation of the 2008 Long-Term RFO of PG&E:

> Specifically, of the factors weighted in the bidding process, PG&E only gave its "environmental leadership" factor 1/25th the weight of its highest factor. The Commission found that this low weighting of environmental criteria was "exacerbated by PG&E's inclusion of a broad range of ill-defined activities under the [environmental leadership] heading . . . and PG&E's 'after the fact' decision to reduce the weight of any scores that clustered together." The Commission further found that the weights placed on environmental factors "[did] not fully reflect this Commission's stated priorities," and said PG&E "should and could have… more accurately reflected the Commission's stated priorities by giving greater weight to environmental factors and enhancing definitions related to environmental scoring."[13]

From IEP's perspective, the issue is not whether or not environmental justice should be a specific element of the bid evaluation or whether it should receive a higher weighting. The point is that if the bid evaluation process is more transparent, the bid evaluation factors and the weights assigned to them should reflect the attributes that are most important to the utility. Potential bidders can then structure their offers and their projects to best fit the needs of the utility. Greater transparency will also reveal whether or not the criteria and weightings of the bid evaluation factors are reasonable. The result will be more refined, higher-quality bids that fit the utility's needs.

The arguments against transparency in bid evaluation unintentionally reinforce IEP's point. According to one utility:

> Common sense dictates that a buyer should not reveal its valuation considerations to potential sellers as it undermines the buyer's procurement leverage. For example, a buyer seeking to purchase a car would be ill advised to inform the car dealers it visits as to the

[13] Pacific Environment's Opening Brief, pp. 36-37, quoting D.10-07-045, p. 20.

SB_GT&S_0624088

> amount of money the buyer is prepared to spend, how much the buyer values certain vehicle options, and the buyer's break-even point between incentives for financing or purchase rebates.[14]

Contrary to these assertions, a buyer seeking to buy a car, particularly one entertaining offers from multiple dealers (as utilities do in RFOs), would be ill-advised **not** to provide the competing dealers with information about what kind of vehicle the buyer is looking for—convertible or SUV? two-passenger, five-passenger, or seven-passenger? four, six or eight cylinders? any minimum fuel efficiency requirements? new or used? And if the buyer prefers one color over another, it should let the dealers know about that preference. If the buyer does not provide this basic information to the dealers, the buyer may receive dozens of bids, but only a handful that happen by coincidence to offer some of the basic characteristics the buyer desires.

Of course, IEP is not suggesting that the IOUs should reveal "the amount of money the buyer is prepared to spend." But IEP is proposing that the IOUs should disclose "how much the buyer values certain . . . options"—not the exact dollar amount but the value of desired characteristics in relation to other attributes, for the simple reason that if the IOU does not let bidders know what attributes it values, it is less likely to get bids that include those attributes.

The studies referred to in IEP's testimony reach similar conclusions:

> We do not intend to suggest that utilities release their actual reference levels for future electricity prices. Rather, we argue that it is important that they 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.[15]

---

[14] Exh. 215, p. 19 (SCE/Cushnie).

[15] 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, p. 16, quoted in Exh. 2000, p. 11 (IEP/Monsen).

SB_GT&S_0624089

> To the extent possible, utilities [that use simulation models in bid evaluation] 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.[16]

IEP's emphasis on specific product definition and disclosure of certain bid evaluation parameters is designed to improve the efficiency of the procurement process. Clear and specific product definition means that bidders do not waste time and resources preparing bids for projects that are of no interest to the utility. Disclosure of certain bid parameters means that the utilities and the Commission do not have to waste time and resources evaluating offers that are only vaguely related to the utility's procurement needs.

B. Comparisons of UOG Projects and IPP Resources Should Be Fair

Several parties representing varied interests agreed with IEP's point that the existing procurement framework unfairly favors UOG projects over IPP proposals and that key components of the current process need to be changed.

1. Fair Comparisons of Projects with Different Commitment Terms

One problem that has hounded attempts to make fair comparisons between UOG and IPP projects is the fact that recovery of the capital costs of UOG projects 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 for conventional resources and 15 to 25 years for renewable resources. This mismatch skews any UOG-IPP comparison. As DRA put it, "Increasing the length of time over which the costs of a UOG project are amortized can have the immediate effect of making a UOG project appear

[16] 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. 29, quoted in Exh. 2000, p. 13 (IEP/Monsen).

SB_GT&S_0624090

substantially more cost competitive than a PPA."[17] Pacific Environment also noted that different amortization periods also tilt comparisons in favor of UOG projects.[18] A comparison of projects with different amortization periods will favor the project with the longest commitment, usually the UOG, unless special care is taken to adjust the valuation to account for differences in terms.

PG&E's response to this issue is to claim that its existing approach, which "uses levelized values . . . to account for the effect of offers with different lengths,"[19] is sufficient. However, PG&E's approach to this issue drew strong criticism in the Commission's decision rejecting PG&E proposed acquisition of the Manzana wind project:

> [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.[20]

Mr. Monsen, IEP's witness, also found that "[c]alculating the levelized cost of power over the life of the PPA instead of the resource life misstates the net cost that the IOU incurs associated with that particular resource decision,"[21] and that correcting for this error reduces the levelized cost of an IPP's bid for a 10-year PPA, in comparison with a UOG proposal, by about a third.[22]

IEP proposed two ways to address this problem. First, arbitrary limits on the terms that IPPs can propose in their bids should be prohibited.[23] IPPs should be allowed to

---

[17] DRA's Opening Brief, p. 32.
[18] Pacific Environment's Opening Brief, p. 43. See Exh. 2300, p. 7 (WPTF/Ackerman).
[19] PG&E's Opening Brief, p. 20.
[20] D.11-03-036, p. 27.
[21] Exh. 2000, p. 20 (IEP/Monsen).
[22] Exh. 2000, p. 21 (IEP/Monsen).
[23] Exh. 2000, p. 18 (IEP/Monsen).

SB_GT&S_0624091

propose durations for their proposed PPAs up to the period used for evaluation of the UOG project. Second, the period of levelization for IPP contracts should be extended to the entire useful life of the IPP facility (typically 30 years, the same period of levelization assumed for UOG projects).[24]

Other parties offered similar proposals to address this problem. DRA, for example, recommends that UOG project costs should be amortized over the same term as the PPAs with which the UOG project is being compared.[25]

As the Commission recognized in its decision on the Manzana acquisition, using different amortization periods to compare different resources can greatly distort the comparison and can lead to the selection of a UOG project over an IPP proposal that is ultimately less costly for ratepayers. The Commission should correct this distortion by directing the IOUs to amortize both IPP projects and UOG proposals over their full useful lives for purposes of bid evaluation and comparison.

2. IOUs Should Not Recover the Costs of Project Development or Failed Projects from Ratepayers

If IPP projects and UOG proposals are to compete fairly, it is obvious that the costs associated with the development of the UOG project and the preparation of any bid or equivalent proposal for the UOG project should not be subsidized by ratepayers. The Commission recognized this principle in D.09-03-025, when it concluded that "from a policy perspective, we feel it is important that the project development costs for proposed new [UOG] projects should not be specifically included in rates."[26]

---

[24] Exh. 2000, p. 21 (IEP/Monsen).
[25] DRA's Opening Brief, p. 32.
[26] D.09-03-025, p. 42, quoting D.06-05-016, p. 53.

The Commission has applied the same principle to the development costs for unsuccessful projects:

> . . . 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.[27]

Despite the Commission's clear adherence to and reiteration of this basic principle, PG&E asserts, "The IOU should be able to recover its costs for a failed bid from ratepayers."[28] PG&E backs this assertion with the mistaken assumption and erroneous conclusion that "IPPs can recover offer development costs for a losing PPA proposal through subsequent winning offers," a claim that reveals a fundamental ignorance of how competition for PPAs works from a bidder's perspective. If an IPP spends $1 million developing a project (including site selection, feasibility studies, securing options on land and equipment, and bid preparation) and submits a $10 million bid that is not selected in the RFO, PG&E seems to think that the IPP can then recover the cost of developing the project for one RFO by submitting a bid for $11 million in the next RFO one or two years later. In fact, no two RFOs are exactly alike, and each bid must be carefully tailored to meet the specifications of the RFO. Furthermore, the intense competition for PPAs dictates that any IPP who attempted to recover the costs of an unsuccessful bid in a subsequent bid would end up only with the additional costs of another unsuccessful bid, not with extra revenues that could offset the costs of previous unsuccessful bids. For IPPs, the costs of unsuccessful bids are "recovered" only in reduced earnings. The IPP's equity holders absorb the costs of unsuccessful bids, and the same principle should apply

---

[27] D.06-05-016, p. 52.

[28] PG&E's Opening Brief, p. 23.

to the costs of a failed bid for a UOG project: shareholders, not ratepayers, should bear these costs.

DRA agrees that "shareholders, not ratepayers, should finance the costs of developing a UOG bid and should absorb the costs of UOG bids that are not approved."[29] WPTF concurs that this basic principle should extend to projects characterized as "utility development offers" that were not clearly addressed in D.07-12-052's prohibition on recovery from ratepayers of bid development costs for losing bids for Purchase and Sale Agreements or Engineer, Permit and Construct proposals that result in UOG.[30] Pacific Environment also opposes PG&E's request.[31]

The Commission should again state the principle that UOG projects and IPPs should face the same risk of cost recovery, and that utilities should not recover the costs of project development or failed projects from ratepayers.

3. Risk and Uncertainty Should be Accounted for as an Element of Cost

IEP pointed out that comparisons between UOG projects and IPP proposals must account for the risk and uncertainty inherent in cost-of-service ratemaking—the actual costs of a UOG facility once construction is completed and the plant is in operation may exceed the original cost projections for the project. IEP proposed that for bid evaluation purposes, the historical variance in costs should be calculated and a bid adder assigned to specific cost elements to reflect this risk.

Other parties agreed with IEP's basic point but proposed a variety of solutions to the problem. DRA urged the Commission to set cost caps for capital costs and operation and

---

[29] DRA's Opening Brief, p. 34.
[30] WPTF's Opening Brief, p. 11-12; see D.07-12-052, p. 207.
[31] Pacific Environment's Opening Brief, p. 44.

SB_GT&S_0624094

maintenance (O&M) costs for UOG projects and to establish pay-for-performance mechanisms for UOG that mimic the pay structures under PPAs.[32] The Utility Reform Network (TURN) recommended that the critical cost parameters of a UOG bid, including initial capital costs, capital additions, fixed and variable O&M, and heat rates, would be binding on the utility for the first ten years of project operation.[33] The reasons for TURN's recommendations are similar to those IEP expressed:

> Given the typical treatment for UOG resources, in which IOUs are not held to forecasts of cost or performance after the project achieves initial commercial operation, the Commission must take action to create real accountability so the original selection process is not unfairly biased in favor of UOG. [¶] Absent this type of accountability, IOUs have an incentive to assume superior long-term cost and performance advantages of UOG projects. Since the Commission rarely, if ever, revisits these initial assumptions, there is no penalty to making overly optimistic projections that are never realized. . . . The absence of any accountability mechanism only emboldens IOUs to game this process to the benefit of shareholders and the detriment of ratepayers.[34]

All these approaches address the same basic problem—the potential that ratepayers will incur costs in excess of the costs the utility used to justify the selection of the UOG project when the project was proposed. IEP's bid adder proposal has the additional virtue of trying to address this risk in the bid selections process, *before* ratepayers become committed to bear the subsequent higher costs of the UOG project. If the risks and uncertainties of a UOG project are assessed at the time of bid evaluation, there is a better chance that a superior and less costly IPP proposal will not be rejected due to the "overly optimistic projections" used to tout the UOG project.

---

[32] DRA's Opening Brief, pp. 33-34.
[33] TURN's Opening Brief, p. 7.
[34] TURN's Opening Brief, p. 8.

SB_GT&S_0624095

4. Project Viability Needs Greater Emphasis

IEP gave special emphasis in its testimony and Opening Brief to the need for the bid evaluation process to do a better job of screening out projects that are not likely to achieve operation. The current contract failure rate of 30-40% is too high and results in wasted time and resources for bidders, utilities, independent evaluators, procurement review groups, and the Commission's staff.

Pacific Environment also notes problems with the assessment of project viability. In Pacific Environment's view, bids should meet certain minimum standards—including demonstrated land control, a showing of the technical and economic feasibility of the technology, a permitting plan, and completion of interconnection feasibility studies—to demonstrate viability, even before the project viability calculator is used to compare competing bids.[35]

Pacific Environment's comments echo IEP's point that improving the viability record of the projects selected though an RFO involves considerably more than giving greater weight to the project viability calculator, although that is also an important step to take. The entire RFO and bid evaluation process should be engaged in the effort to identify the projects that are unlikely to reach operation. This engagement begins when the utility identifies the specific attributes that best fit the current and projected needs of its system, expresses those attributes in a specific product definition, and informs bidders of how important those attributes are in relation to other characteristics, *i.e.,* how the components of competing bids will be evaluated.

---

[35] Pacific Environment's Opening Brief, p. 41.

SB_GT&S_0624096

III. IEP PRESENTS A FAIR, FLEXIBLE, AND TRANSPARENT FRAMEWORK FOR BID EVALUATION

In response to the Commission's identification of refinements to the bid evaluation process and particularly comparisons between UOG and PPAs as an issue within the scope of Track III of this proceeding, IEP's witness, William Monsen, presented a detailed proposal that included an illustration of how the proposed framework would be applied. The utilities' criticisms of this proposal took many forms, but one common tactic seemed to be to ignore the actual proposal IEP presented and to then attack a distortion of the actual proposal as if that were being presented for the Commission's consideration.

PG&E, for example, claims that IEP's proposal fails to account for "diversity in counterparties, technology, location and other criteria considered for RFO offers" and that IEP's approach "does not allow an IOU to weight certain attributes more heavily depending on the need addressed in a particular RFO."[36] But in fact IEP's proposal is specifically designed to allow utilities to identify the criteria that are important to the utility and to communicate those criteria to bidders. As Mr. Monsen stated:

> If bidders had a better understanding of the relative value of the bid evaluation factors (which should reflect the relative value that the utilities place on different power project attributes), the IPPs could plan and propose projects more suited to the needs of the utilities, thereby improving competition and helping ensure that the projects selected truly are the "best fit" in light of the utility needs and specifications.[37]

PG&E similarly accuses IEP of failing "to differentiate between the importance of different criteria, such as market value, viability and environmental characteristics,"[38] an

---

[36] PG&E's Opening Brief, p. 21.
[37] Exh. 2000, p. 8 (IEP/Monsen).
[38] PG&E's Opening Brief, p. 21.

SB_GT&S_0624097

accusation that is wrong on both a factual and conceptual basis. Factually, Mr. Monsen **did** differentiate between four general categories of attributes, *specifically including* the present value of financial benefits (*i.e.,* market value), project viability, and environmental characteristics, and PG&E's accusation is patently wrong.[39] Conceptually, PG&E is wrong because it is not up to IEP to tell PG&E what its procurement priorities are. **PG&E** (and the other IOUs) should determine what attributes are most important to meet the needs of its system and communicate those attributes and their relative importance to bidders, so that the bidders can then respond with proposals that provide those attributes.

Thus, the criticisms PG&E raises of IEP's proposal are the products of its own misunderstanding or distortion of the actual proposal.

SCE raises two basic objections to IEP's proposal. First, SCE argues that since it does not intend to submit UOG proposals into a competitive solicitation, it should be exempt from any refinements to its bid evaluation and RFO process. However, while SCE may currently have no intention of developing its own UOG projects, its plans can change at any time. Even if SCE does not plan to develop UOG projects, the Commission needs a comparison methodology that it can apply today to evaluate proposals from those utilities that are currently interested in developing UOG projects. SCE's position also overlooks the fact that the issue as described in the scoping memo concerned refinement to the bid evaluation process, particularly—but not exclusively—with respect to UOG bids. As Mr. Monsen explained, "The proposed bid evaluation framework can be used even if no bids for UOG projects are submitted; however, some of the factors in the bid evaluation framework would not be relevant if only IPP projects

[39] Exh. 2000, p. 37, App. A (IEP/Monsen).

SB_GT&S_0624098

bid into a particular solicitation."[40] And IEP's broader points concerning improved transparency and more specific product definition are relevant whether or not a UOG project participates in an RFO.

SCE's second objection is that disclosing its bid evaluation factors and weighting "would reveal highly market-sensitive, confidential information to the detriment of utility customers."[41] SCE fails to explain, however, why or how making known to bidders the attributes it wants to acquire and the relative importance of those attributes will result in harm to ratepayers. IEP's proposal is designed to elicit informed bids that are responsive to the needs the IOU has identified, and it is hard to see how bids that are focused on meeting the needs the utility identifies could be harmful to ratepayers. Moreover, SCE's elaboration of its concern—" a bidder could introduce pricing terms or present its bid in a manner that the utility bid valuation process does not fully capture"[42]—is neither clear nor compelling. These are precisely the concerns identified and rebutted in one of the studies quoted in IEP's testimony:

> Leaving theory aside for the moment, conventional thinking in the utility sector has typically resulted in very limited information disclosure by the utility running the RFP. Utilities tend to be protective of the various methods, inputs, forecasts and projections they use internally to develop their market valuation, which then guides the bid evaluation process. Utilities may fear that their forecasting and analytical approach, if made public, could be discredited. They may also worry they would be at a disadvantage should they find themselves competing directly with a bidder in the future under a different context (as these are "repeated" markets with various dimensions, a supplier can become a buyer in the future). Finally, there is a general concern that bidders may use information provided to take advantage of the utility soliciting offers by pricing in a non-competitive manner. For example, if a utility publishes their own opportunity cost for securing supplies through other means, bidders may target that opportunity cost

[40] Exh. 2000, p. 8 fn.8 (IEP/Monsen).
[41] SCE's Opening Brief, p. 23.
[42] Exh. 221, p. 19 (SCE/Cushnie).

SB_GT&S_0624099

> when they make their offer, instead of their own expectations and marginal costs. This concern would only be valid if there is truly an insufficient level of competition. If there is sufficient competition, suppliers will bid based on their marginal cost (which may not necessarily be their physical production cost, but should represent their marginal opportunity cost), even if they know the buyer's reference purchase price, because they can do no better by bidding below their costs (why take on a commitment that is unprofitable?) or bidding above their costs (they may risk not being selected at all because of more competitive bids from other suppliers).[43]

In addition, IEP's proposed methodology is designed to aid in the selection of projects for the RFO's shortlist,[44] and the utility and the Independent Evaluator, in consultation with the utility's Procurement Review Group, will have ample opportunity to fully vet the shortlisted offers and to screen out any that made improper use of the bid evaluation information.

For its part, SDG&E's primary response to the Commission's request for refinements to the bid evaluation and RFO process is a ringing endorsement of the status quo.[45] Like PG&E, SDG&E anchors its critiques of IEP's methodology on misstatements and distortions of what IEP actually proposed.

For example, SDG&E correctly notes that Mr. Monsen assumed that capital costs, heat rates, and O&M costs for IPP projects would be fully specified, *i.e.,* incorporated in the bid. But SDG&E then goes on to accuse IEP of ignoring "equivalent costs and risks faced by ratepayers in connection with IPP projects."[46] In fact, however, Mr. Monsen recognized that any

---

[43] Frayer, Neeman, and Wittenstein, p. 3, quoted in Exh. 2000, pp. 9-10 (IEP/Monsen).

[44] Exh. 2000, p. 46 (IEP/Monsen).

[45] SDG&E's support for the status quo for comparisons of UOG and IPP may be colored by the fact that SDG&E owns or has an option to own over 1,700 MW of gas-fired capacity, nearly all of the new capacity brought on line since SDG&E divested its fossil generation resources in 1998. See D.06-09-021 (Otay Mesa), D.09-01-008 (Miramar II), D.07-11-046 (El Dorado), D.05-08-005 (Palomar). See also A.11-01-004 (CalPeak El Cajon).

[46] SDG&E's Opening Brief, p. 27.

SB_GT&S_0624100

risks that IPPs present to ratepayers should also be part of the bid evaluation: "If a PPA were structured to assign some of these risks to ratepayers, adders would need to be assigned to the appropriate cost elements to reflect this risk."[47] This statement clearly refutes SDG&E's accusation that "IEP fails . . . to propose any adjustment or adders related to IPP projects equivalent to those proposed for UOG."[48]

SDG&E also criticizes IEP for failing to account for degradation of a plant's heat rate over time, saying "there is no reason that a UOG plant would experience more or less degradation than an independently-owned plant."[49] SDG&E again avoids the point of the adder. The adder is **not** used for bid evaluation of a UOG project because the UOG project's heat rate is expected to degrade faster than a comparable IPP project. It is applied to evaluate the UOG project because under cost of service ratemaking, ratepayers will bear the increased costs resulting from the heat rate degradation. By contrast, ratepayers will bear no such increased costs when the heat degradation is accounted for in the price under a PPA. Moreover, SD&E's argument that increased O&M costs are required to be approved for recovery by the Commission[50] does not lessen the effect on ratepayers. Even if the Commission eventually approves the higher O&M costs for recovery, the increased costs are still not reflected in the bid evaluation or in the comparison with projects that may have resulted in lower costs for ratepayers.

IV. THE NEED FOR ADDITIONAL PROCUREMENT MECHANISMS

Although the proposed Track I settlement provides that there is no basis to

---

[47] Exh. 2000, p. 41 (IEP/Monsen).
[48] SDG&E's Opening Brief, p. 27.
[49] Exh. 315, p. 8 (SDG&E/Anderson).
[50] SDG&E's Opening Brief, pp. 28-29.

conclude that additional generation resources are needed in the near term, three different parties have presented the Commission with proposals for mechanisms that will allow for procurement of resources to meet specific resource needs.

SCE proposes that the California Independent System Operator (CAISO) should conduct an auction every three years to procure new generation needed for local resource adequacy and renewables integration.[51] Calpine called for the Commission to direct the IOUs to conduct intermediate term (3-5 years) solicitations to procure flexible resources to support renewables integration and to provide a potential source of revenues to existing resources that can provide those flexible services and that might be forced into retirement in the absence of a new source of potential revenues.[52] In the Resource Adequacy (RA) proceeding, R.09-10-032, the CAISO proposed to expand the RA procurement requirements to include non-generic capacity to add regulation and ramping capabilities needed to meet the operational challenges presented by the addition of large amounts of variable renewable energy.[53]

Even though the Track 1 modeling effort could not support a conclusion that additional capacity is needed at this time, it is striking that parties with such different interests seem to agree that it is prudent for the Commission to take steps *now* to ensure that the needed resources with the needed characteristics are available when needed to support the expected rapid influx of energy from wind and solar resources.

IEP notes that the CAISO concurs with Calpine's conclusion that the loss of flexible existing resources could hinder the operation of the grid. "It is possible that economic

[51] Exh. 211, p. 5 (SCE/Brady).
[52] Exh. 601 (Calpine/Barmack).
[53] Motion of the California Independent System Operator Corporation for Expansion of the Phase 2 Scope to Include a Proposal for Procurement of Non-Generic Capacity through the Resource Adequacy Program, R.09-10-032, Nov. 30, 2010.

SB_GT&S_0624102

retirements could . . . cause the ISO to rely on backstop mechanisms to maintain system reliability. In addition, . . . the ISO could lose the operational flexibility that can be obtained through small investments to existing facilities."[54] The CAISO concludes:

> The ISO agrees that a "gap" currently exists between the ISO's renewable study assumptions that existing resources modeled in the 2011-2020 time period will actually still be part of the fleet when needed as the system approaches 33% renewables, and the reality that some, or many, of these units could face economic retirement if not procured under long-term contracts. Clearly this gap must be addressed and the Commission in this proceeding has the opportunity to design a flexible solicitation process and intermediate term procurement directive as suggested by Calpine.[55]

IEP agrees with the CAISO that a "gap" exists that must be filled. A well-functioning electricity market would both stimulate investment in new capacity when needed and provide opportunities for existing plants to earn sufficient revenues to operate and maintain their facilities. The Commission chose not to establish a capacity market that might have provided that opportunity, but the Commission has not yet provided other opportunities for existing resources as they reach the end of their initial PPAs.[56] As a result, the facilities that might be the most logical and cost-effective providers of the flexibility needed for renewables integration are threatened with retirement, not because of their true economics in relation to other units, but because of distortions in existing power markets and procurement practices.[57]

---

[54] CAISO's Opening Brief, p. 7.

[55] CAISO's Opening Brief, p. 8.

[56] If IPPs foresee no source of additional revenues after the end of their PPAs, they will be forced to recover all capital costs during the term of the PPA, leading to higher bids and ultimately to higher costs for ratepayers.

[57] The suggestion that bankruptcy or a distressed asset sale is an appropriate path for resources after the expiration of their PPAs (Exh. 1505, p. 4 (TURN/Woodruff)) is hardly an appealing invitation for investment in California.

Calpine has proposed a reasonable, focused procurement that would help to bridge this gap at the lowest cost to ratepayers. IEP respectfully urges the Commission to adopt Calpine's proposal or, in the alternative, define a procedural path that will lead to a timely decision on how to fill the gap that Calpine has identified.

V. CONCLUSION

IEP's proposal in this proceeding can be reduced to a few simple principles:

1. Utilities should clearly identify the functions or products that they hope to procure, including the attributes that are most important to the utility's resource needs.

2. The importance of certain functions or attributes relative to other functions or attributes should be reflected in the bid evaluation and communicated to potential bidders.

3. When UOG proposals are considered at the same time or in the same RFO as IPP bids, the differences between UOG and IPPs' projects must be accounted for in the bid evaluation:

   a. Different commitment terms must be equalized for bid evaluation purposes.

   b. Project development costs must be reflected in the costs used for bid evaluation.

   c. The cost of failed bids must not be borne by ratepayers.

   d. The risk that the UOG project's eventual costs will exceed its initial cost estimates must be accounted for in the comparison.

4. Project viability must be given greater weight throughout the RFO and bid evaluation process.

These principles in a sense are elaborations and responses to the concerns the Commission expressed in the 2006 LTPP decision:

> 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 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.[58]

This proceeding gives the Commission the platform to take some concrete steps to address the problems it identified nearly four years ago and to create the opportunity for "ratepayers [to] benefit fully . . . from competition [and] from the utilities' participation in a hybrid market." IEP has accepted the challenge of proposing a methodology that allows for a fair comparison between UOG proposals and IPP bids, a challenge that other parties shied away from. Contrary to the suggestion of some of IEP's critics, IEP did not purport to prescribe all the details of the comparison methodology. Instead, IEP offered a carefully thought-out framework for bid evaluation, an algorithm for comparison of bids, and a complete example of how the methodology could be applied.

IEP respectfully urges the Commission to adopt IEP's proposed framework and to

[58] D.07-12-052, p. 155.

order the utilities to:

- Define the product sought in RFOs with as much specificity as possible;
- Make available key 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;
- Retool the product definitions and the bid evaluations for RFOs to identify the projects that are most likely to achieve operation and to provide the products and characteristics that are most important to the utility;
- Eliminate any caps on IPP contract terms and give the proposed term of the contract appropriate consideration in bid evaluation;
- Allow existing units that can provide the product sought in an RFOs to bid into the RFO without exclusion;
- Include all of the utility's project and bid development costs in the cost of the UOG proposal for bid evaluation purposes;
- Incorporate the cost of ratepayer risk associated with UOG and IPP projects in the bid evaluation process;
- Use IEP's proposed bid evaluation methodology and algorithm as a model for the IOUs' bid evaluations; and
- Provide Energy Division with the data needed to develop adders for cost elements of UOG proposals.

In addition, IEP respectfully urges the Commission to adopt Calpine's proposal for intermediate term solicitations to procure flexible resources to support renewables integration

or, in the alternative, define a procedural path that will lead to a timely decision on how to fill the gap that Calpine has identified.

Respectfully submitted this 3rd day of October, 2011 at San Francisco, California.

GOODIN, MACBRIDE, SQUERI,
DAY & LAMPREY, LLP
Brian T. Cragg
505 Sansome Street, Suite 900
San Francisco, California 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
Email: bcragg@goodinmacbride.com

By *_/s/ Brian T. Cragg_*
Brian T. Cragg

Attorneys for the Independent Energy
Producers Association

2970/024/X132049.v4