

**Power Purchase Agreements
Workshop
Bamako, Mali
July 28-30, 2004**

Kim Wissman
Deputy Director
Utilities Department
Public Utilities Commission of
Ohio

SIX KEY ISSUES

- Comparability
- Transmission Assessments
- Cost-plus Offers
- Unequal Lives
- Creditworthiness
- Balance Sheet Penalty

Why Competitive Solicitations???

- Central role in getting the best possible deal for customers
- At state level, it provides a modern prudence review standard
- At federal level, it meets needed requirements to prevent affiliate abuse

STATE REGULATORY COMMISSIONS

- Price
- Risk
- Reliability
 - Generation – Physical availability
 - Transmission – Being able to deliver
- Environmental Performance

Prudence Review

- A reasonable decision-making process in which all alternatives are evaluated in an equitable and comparable manner with all available information and facts which were known, and should have been known at the time.
- Not to judge the decision as favorable or not, but rather a logical process including all of the above.

Affiliate Bias

- Assurance the solicitation process did not favor the affiliate
- Analysis of the bids or responses did not favor the affiliate, and
- The affiliate was chosen based on a reasonable combination of price and non-price factors

Ensuring a Credible Solicitation

- Collaborative Process
- Independent, Third-Party Monitor

Collaborative Process

Strive for full consensus on most issues

- Amount of power
- Type of power
- Evaluation criteria

Three Key Steps to Collaborative Process

- Local utility submits proposed approaches
- Series of (Commission facilitated) meetings allowing for significant stakeholder input
- Prompt resolution of outstanding issues by State Commission

Eight Recommended Steps

1. Independent monitor chosen by commission
2. Submission of forecasted resource requirements by utility
3. Multi-day collaborative meeting for open discussion among market participants. Staff and utility to determine amount and types of products to solicit

Eight Recommended Steps con't.

4. If consensus reached, resource requirements phase is over; if consensus is not reached, monitor or staff submit a report to commission with recommendations, participants file comments, commission provides prompt resolution.
5. Utility submits draft solicitation package

Eight Recommended Steps con't.

6. Another multi-day meeting to address bidder qualifications, terms of a model PPA, bid evaluation techniques and criteria, etc.
7. If consensus reached, Request for Proposal phase is over; if consensus is not reached. monitor or staff submit a report to commission with recommendations, participants file comments, commission provides prompt resolution.

Eight Recommended Steps con't.

8. Request for Proposal issued. Local utility responsibility to select winning bid(s); however, independent monitor has full access to all communications throughout the process.

Some Cautionary Notes

- Watch for litigation and delay
- Limit time for objections
- Limit scope of objections
- Strive for clarity and certainty early in the process

Independent Third Party Monitor

- Facilitation
- Credibility

Independent Third Party Monitor

- Extra layer of review
- Technical expertise
- Fair and impartial

Independent Third Party Monitor

The decision to use an independent monitor:

- Desire to assist state regulatory commission staff with logistical and technical assistance
- Whether a utility affiliate or utility self-build option participates in the solicitation
- Assessment of the need to enhance confidence among the stakeholders

CHOOSING A SOLICITATION

Format and Product Type

- Request For Proposals (RFPs)
- Price Only Auction

RFPs

- Allow variety: Capacity sizes, start dates, term lengths, pricing structure, demand-side-management, renewable, etc.
- Enable competitive suppliers to provide generation under the same terms and conditions that the utility would apply to its own generation, allowing like comparisons.
- Provides more competitive options

RFP

A potential downside to RFP when more flexibility is allowed is increased difficulty of comparing proposals:

- ❑ leading to less transparent comparisons,
- ❑ more discretion, and
- ❑ potentially more biased decisions.

Price-Only Auction

- Winners chosen solely on basis of price
- All non-price factors are settled in advance
- Multiple rounds of price bids

Descending clock auction has been widely accepted, in which an auctioneer announces prices in descending order until a price is reached at which the supply power offered is just sufficient to meet load.

Price-Only RFP vs. Price-Only Auction

- Descending clock auction, multiple rounds of price bidding occur, however ALL winning bids are paid a uniform price.
- Price-only RFP, bidders submit a price offer and winners are paid the price of the bid.

Benefits of Price-Only Approach

- Transparency due to all non-price issues being resolved
- Limitation on utility's exposure to market risk by awarding the supplier a percentage share of the utilities load rather than a fixed megawatt supply
- Limitation on the suppliers' exposure to keeping bids open

Detriments of Auctions

- Generally a short-term length of purchase (one-two years)
- No opportunity for suppliers to offer lower prices due to other varied requirements

Bid Evaluations

Six Key Issues

- Principle of comparability
- Transmission assessments of bidders
- Cost-plus offers versus pay for performance bids
- Comparing bids with unequal lives
- Creditworthiness concerns
- Balance sheet penalties

Comparability

Do Unto Others as You Would Have Others Do
Unto You

All bidders should meet the same requirements and be evaluated under the same standards so that no single bidder has an unfair advantage over another bidder

Transmission Assessment

It is very difficult to fairly and accurately assess the deliverability of a bidder's power

Transmission Assessment

Comparable treatment

- ❖ System upgrades
- ❖ Transmission related costs incurred
- ❖ Who pays for upgrades

Transmission Assessment

Some examples/cautionary notes

- ❖ If required to be a network resource, must provide timely and fair estimate of needed transmission upgrade
- ❖ Transmission assessments/costs are often inflated
- ❖ If transmission constraints are found for certain bids at the time of the bid, those bids could be unduly rejected for entire term of the proposal

Cost-Plus Offers

- No guarantee of the customer benefits asserted
- In contrast to a pay-for-performance offer where bidder guarantees customer benefits asserted in the offer.

Cost-Plus Offers

- Key is to properly evaluate higher risk this imposes on the customer.
- Ways to address the added risk to customers
 - Limit payments the cost-plus seller receives to estimates provided by the seller in its offer during solicitation
 - Apply a risk-premium to the offer, based on historical experience on cost pass-throughs with similar technologies

Unequal Lives

- Annuity Method – an annuity is an equal annual payment over the life of the investment that has the same present value as the actual, unequal annual costs of the investment
- Utility “fills-in” the price and terms between the two offers

Creditworthiness Concerns

- Regulators must be concerned about how suppliers will contractually fulfill their obligations
- Ideally, participants should address and agree on mitigation of these concerns during collaborative process so there is understanding of obligations

Nature of risk

Mitigation means

Creditworthiness Concerns

- Measures (terms and conditions in a PPA) to physically provide comfort of generation delivery
- Requirements for replacement cost of power, either asset-backed or financial
- Assessment of bidder's financial status/collateral requirements
 - Cash
 - Parent guarantee
 - Letter of credit

Balance Sheet Penalty

- Some utilities have been permitted to reflect an adverse effect on their balance sheets from signing with a third party
- PPA capacity payments are sometimes the equivalent of debt

Balance Sheet Penalty

- Could include this in the bid evaluation --due to added debt, the utility will need to add more equity to its balance sheet
- Equity costs more than debt, therefore there is a cost to signing third-party PPA
- Cost can be used as a penalty against non-utility bids

Conclusion

- Regardless of solicitation format, products and approaches used, keep the goal in mind.
- Customers, utilities and regulators desire reliable and affordable power
- Bidders want to sell their power
- Fair and credible evaluation of the full range of resource alternatives.
- Obtaining the best deal for customers – least cost and optimum mix of resources.