COMPETITIVE PROCUREMENT: A GUIDE TO GETTING THE BEST DEAL FOR CUSTOMERS

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www.epsa.org
CNF DISCUSSION AGENDA

Perspective of Competitive Power Sector
- Asking the right questions
- Proper risk management/allocation is essential
- ‘Reliability Option’ should embrace competitive plants

CNF Outcome
- Supply portfolio that best fits customer needs
- Preserve customer choice and competitive markets
- Market test for new supply – evaluation equity
- Comply with intent of current Michigan law
IRP IN THE 21ST CENTURY

  - Utility-specific; less emphasis on regions
  - Resource planning – traditional supply, renewable sources, customer demand, demand-side management

- Comprehensive Resource Planning – 2005
  - Utility-specific, but regional considerations
  - Role of procurement – a permanent option
Market Competitiveness

- Competitiveness of Markets – Structure/Conduct/Performance
- "Contestability" of Markets – Barriers to Entry
- Competitive Procurement – Improve Contestability of Wholesale Markets

Procurement
- Diagnostic role
- Prescriptive role
BARRIERS TO ENTRY

- Significant Problem
- Manifested in Three Ways
  - Inability to gain access to capital
  - Inability to gain transmission access
  - Inability to gain access to customers
- Three Adverse Effects
  - Prevent economic sales to local utility
  - Prevent economic sales to other customers
  - Reduce likelihood of new market entry
COMPETITIVE PROCUREMENT

- Serves Many Masters
  - Reduces affiliate preference
  - Reduces transmission market power
  - Improves price discovery and market liquidity
  - Improves risk allocation
  - Improves access to capital markets
  - Improves reliability

- Many Approaches to Procurement
GETTING the BEST DEAL for Electric Utility Customers

A Concise Guidebook for the Design, Implementation and Monitoring of Competitive Power Supply Solicitations

ELECTRIC UTILITY RESOURCE PLANNING:
THE ROLE OF COMPETITIVE PROCUREMENT AND DEBT EQUIVALENCY

Electric Power Supply Association
Prepared by GF Energy LLC
July 2005
ESSENTIAL ELEMENTS OF COMPETITIVE SOLICITATIONS

- Importance of Competitive Solicitations
- Holding Credible Solicitations
- Ensuring Proper Solicitation Format
- Fair and Accurate Bid Evaluations
COMPETITIVE SOLICITATIONS

- Recent Focus on Shorter-Term Power Procurement (0-3 years)
  - Load auctions and utility RFPs
  - Emphasis on energy, ancillary service products

- Longer-Term Procurement (3+ years)
  - State-sanctioned solicitations and RFPs
  - Asset-backed capacity and energy
  - Financing vehicle for new infrastructure
  - Price-only auctions to more extensive RFPs
STATE PRUDENCE REVIEWS

- Prudence reviews allow the Commission to review electricity procurements in terms of:
  - Price
  - Risk
  - Reliability
  - Environmental performance

- Competitive solicitations demonstrate prudence by showing that a utility fairly evaluated its full range of both utility and non-utility options.
STATE PRUDENCE REVIEWS (cont.)

- Commission may establish a rebuttable presumption that an approved solicitation results in a prudent investment or procurement decision.

- Such a decision would:
  - Shift burden of proof from utility to intervenors
  - Expedite the regulatory review process
  - Ensure utility cost recovery for contracts signed through the approved competitive solicitation process
  - Obviate need for a “regulatory out” clause in the purchase power agreement
CREDIBLE SOLICITATIONS

- **Collaborative Process**
  - Local utility submits recommended RFP approach
  - Multi-day, commission-facilitated meetings
  - Commission resolves outstanding issues

- **Independent, Third-party Evaluator**
  - Performs independent evaluation of the bids
  - Monitors communication between the utility, affiliate
  - Benefit: Extra pair of “eyes”
  - Recent solicitations - ACC, CPUC, GA PSC, PUCO, MD PSC, NJ BPU, UT PSC, WA UTC
CREDIBLE SOLICITATIONS (cont.)

- Fair Process Must:
  - Be free from actual, apparent conflicts of interest
  - Provide all bidders similar access to information
  - Require full public review of the utility decision-making process

- If Utility or Affiliated Entity Participates, Additional Safeguards Required
  - Use of an independent evaluator - reports to commission
  - Separation of utility personnel - utility’s proposal vs. evaluating bids
  - Utility winner must honor its bid prices
PROPER SOLICITATION FORMAT

Format and Product Types

- Requests for Proposals
  - Includes price and non-price terms
  - Non-price terms can include capacity sizes, start dates, term lengths, pricing structures
  - Can be harder to compare
  - Manage risks over time
  - Can include demand response

- Price-only Auction
  - Provides greater transparency
  - Limits exposure to regulatory risk
BID EVALUATION PROCESS
Six Key Issues

- Comparability for all bidders
- Transmission assessments of bidders
- Cost-plus offers versus pay-for-performance bids
- Comparing bids with unequal lives
- Creditworthiness concerns
- Balance sheet penalties
DEBT EQUIVALENCE

- Application of Debt Factor to Long-Term PPAs
- Designed to Impute Debt to Utility Balance Sheets
- Originally Applied by S&P in 1990
  - S&P believed utility-owned generation was disadvantaged vis-à-vis PPAs
  - PPA creates risk by triggering an obligation on utilities to pay a minimum amount in the future
  - S&P applies a risk factor to the future value of expected capacity payments in a long-term PPA
  - Resulting dollar amount is added to bids from suppliers in competitive solicitations
S&P Views Debt Equivalency from Perspective of Bondholders, not Utility Shareholders, Customers

State PUCs Can Address Issue from Perspective of Customers and Shareholders

Issue Just Now Resurfacing at State Level after 12-Year Hiatus from PURPA QF Contracts

As Competitive Procurement Grows, Debt Equivalency Will Become More Prominent

Pendulum Has Swung Too Far Against PPAs
DEBT EQUIVALENCE (cont.)

- Two Venues for Treating Debt Equivalence
  - Resource procurement and bid evaluation
  - Utility cost-of-capital proceeding
- COC Appropriate Absent Comparable Bid Review
  - Imposing debt-like risk on PPAs creates an unfair bias
  - PPA cost recovery no more risky than for rate-based generation
  - COC proceedings evaluate utility’s financial position on a portfolio basis – the bid evaluation is a “one-off” review
  - COC proceedings are the best arena to balance these considerations, not the competitive bid evaluation
CONCLUSION

- Competitive Plants and Reliability Option: Mutually Reinforcing
- Well-Designed, Managed RFPs
  - Excellent prudency tool
  - Full range of resource options
  - Fits Michigan law
  - Best deal for consumers
Questions

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