



## Stakeholder Comment and AESO Replies Matrix

### AESO Consultation – Competitive Process

March 31, 2011

The AESO is asking market participants and interested parties to provide comments on the related Draft Recommendation Paper.

Date of Request for Comment: <u>2011-04-28</u>	Contact: <u>Adam Gassaway</u>
Period of Consultation: <u>2011-03-31</u> through <u>2011-04-28</u>	Phone: <u>(636) 532-2200</u>
Comments From: <u>LS Power Transmission, LLC (“LS Power”)</u>	E-mail: <u>agassaway@lspower.com</u>
Date [yyyy/mm/dd]: <u>2011-04-28</u>	

#### Risk Sharing Options – Cost Recovery / Pricing Arrangements

The AESO seeks stakeholder comments on other risk sharing options the AESO may consider for the AESO Own model.



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<p>LS Power</p>	<p><i>The risk taken by ratepayers and the risk taken by the developer must be balanced so that the ultimate result for ratepayers is a risk adjusted low cost project. Cost-of-service based pricing, (which inherently carries a risk of disallowance for costs not prudently incurred) places a significant amount of the project risk on the ratepayer and provides less incentive for innovation or cost minimization. On the other hand, fixed price bids from the transmission developer place most of the risk on the developer and require the developer to price this risk into its bid. LS Power believes that fixed price bids will result in higher costs for ratepayers and that competitive pressures may not be enough to overcome the cost of risk premiums. Generally, LS Power believes that the best solution is to allow developers the flexibility to propose their own risk sharing approach when bidding. However, it is understood that varying risk sharing concepts and prices can become difficult to evaluate and bring a certain level of subjectivity into the selection process. LS Power suggests that the AESO consider these additional approaches for sharing risk. As mentioned below, it is difficult to fully comprehend risk sharing options without understanding other contract terms. For example, are major changes that are out of the developers' control considered events of force majeure and handled differently? In all of these risk sharing approaches, LS Power believes that it makes sense to have special provisions for significant events that are beyond the developer's control.</i></p> <p>1. <i>Price collars</i>  <i>The general idea is to ensure that developers are incented to perform based on the bid in which they were selected without causing high risk premiums, which would be borne by ratepayers. This approach also incents the developer to outperform its bid and share the upside with the ratepayers. The points below describes one way to approach this concept[;:</i></p> <ul style="list-style-type: none"> <li>• <i>Risk is shared at discrete levels based on developer performance in</i></li> </ul>	



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	<p><i>comparison to its bid.</i></p> <ul style="list-style-type: none"> <li>• <i>At least three tiers of risk sharing would likely be required (See below for an example.)</i></li> <li>• <i>The AESO establishes the number of tiers, the sharing of risk for each, and the price range in comparison to bid prices for each tier</i></li> <li>• <i>Bidders provide a bid price</i></li> <li>• <i>The AESO would select the lowest risk adjusted price.</i></li> <li>• <i>This approach likely requires the separation of operations and maintenance (O&amp;M) costs from development and construction costs. O&amp;M could be handled in similar manner to project capital costs in this option.</i></li> </ul> <p><i>For example the AESO could mandate that if actual costs are +/- 10% from the bid that the impact of the change is passed through to ratepayers on a 100% basis (tier 1); if actual costs are +/- 25% from the bid then only 80% of the amount above tier 1 is passed through (tier 2); if actual costs are +/- 40% from the bid then only 60% of the amount above tier 2 would be passed to ratepayers (tier 3); and if actual costs differences are greater than 40% then the only 30% of the amount above tier 3 is passed to ratepayers.</i></p> <p><i>2. Indexed bids</i>  <i>The AESO could expand on the adjustment proposed for route length and allow a bidder to index additional elements of risk. These may include steel prices, aluminum prices, labor rates, diesel prices, schedule, geotechnical findings (i.e. amount of rock), interest rates, and concrete prices. This approach would allow the developer to propose an adjustment factor for each risk in accordance with those that it can best manage. The AESO would select the lowest risk adjusted bid. One downside to this approach is that it may be more difficult to evaluate.</i></p> <p><i>3. ROE Adjusters</i>  <i>The AESO could propose risk sharing through the use cost of service rates with</i></p>	
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	<p><i>an adjustment mechanism for the return on equity (ROE), based on the developer's performance in comparison to its bid subject to a ROE floor and ceiling. This approach would significantly reduce risk premiums while incenting bidders to outperform their bids.</i></p> <p><i>4. Fixed price bid with risk sharing options</i>  <i>If the AESO chooses to pursue the fixed price bid option, then it may make sense to allow bidders to provide additional prices for sharing of certain risks. The AESO could then choose what, in its opinion, is the best approach. For example, a bidder may propose a fixed price of X and provide the option for a price of Y if steel prices are indexed, or Z if geotechnical risk is shared.</i></p>	
<b>Risk Sharing Options – Cost Recovery / Pricing Arrangements</b>		
<p>The AESO also seeks stakeholder comments on all aspects of its cost recovery / pricing scheme including:</p> <ul style="list-style-type: none"> <li>• the implied allocation of risk under Option 1 and Option 2</li> <li>• O&amp;M escalation provisions including proposed indices</li> <li>• Information the AESO could provide to assist with route estimation in advance of bid submissions</li> <li>• Performance specifications</li> <li>• Contract term</li> </ul>		



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<p>LS Power</p>	<p><i>LS Power notes that it is difficult to fully comment on the two options without reviewing the full contract. Both options place the majority of the project risk on the developer with the exception of route length. While Option 2 helps to reduce some developer risk it does not address what we believe are the major project risks. From our perspective, the up front development work is one of the easier areas of the project on which to provide a fixed bid because the developer has some direct control over the costs. On the other hand, a developer has little control over things like worldwide commodity prices, labor prices, abnormal weather events, unforeseen subsurface conditions, interest rate trends, etc. Some of these risks can be managed once the project has been awarded and some cannot. For those periods of time when these risks cannot be managed in a cost effective manner and for risks that cannot be controlled, LS Power believes that the risks should be shared between the developer and the ratepayer to achieve the best overall value for the ratepayer.</i></p> <p><i>LS Power notes that it is difficult to forecast exact maintenance needs especially without long-term historical maintenance information. If long-term predictable pricing is provided, a menu of unit prices for maintenance tasks coupled with an escalator that considers labor rates and general inflation would probably make the most sense.</i></p> <p><i>It is not perfectly clear how costs are recovered under the two options identified by the AESO. However, we are assuming that the owner would recover all project costs through the operating and maintenance agreement and over the applicable term. It is very difficult to identify an ideal contract term without understanding post contract conditions. If the intent is that the developer would recover all costs over the contract term with no further recovery other than ongoing operating and maintenance expenses, then LS Power believes that the</i></p>	



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	<p><i>AESO should consider a contract term longer than 20 years. Typical transmission infrastructure has a useful life well beyond 20 years and is often financed over terms that exceed 20 years. Contract terms of 20 years or shorter may narrow financing options and increase costs to ratepayers on a net present value basis. LS Power suggests a contract term of either 25 or 30 years. However, in our opinion, requiring a developer to provide fixed or predictable pricing for operation and maintenance expenses over such a long term will not be in the interests of ratepayers. An alternative method for handling operation and maintenance expenses is to request fixed pricing for an initial period (5 years for example) followed by cost based pricing or indexed unit price methodology for the remainder of the contract term.</i></p>	
<b>Arrangements Arising out of Implementation of the Process</b>		
<p>With regard to contractual arrangement arising from the Process, the AESO is seeking stakeholder identification of key project risks and commentary on ways of allocating the otherwise addressing these risks in a fair and equitable manner.</p>		
Stakeholder	Stakeholder Comment	AESO Replies
<p><i>LS Power</i></p>	<p><i>Other ways of addressing and allocating risk in a fair manner were suggested in previous comments. Transmission projects of this scope have numerous layers of risks. Some of these risks can be easily managed, but management of those risks comes at a cost. Risks generally fit into the following categories:</i></p> <ol style="list-style-type: none"> <li><i>1. Development</i> <ul style="list-style-type: none"> <li>• <i>Route length</i></li> <li>• <i>Number of angle points (PI's) in route</i></li> <li>• <i>Permitting</i></li> <li>• <i>Community opposition</i></li> <li>• <i>Litigation</i></li> <li>• <i>Design changes</i></li> <li>• <i>Changes in law</i></li> </ul> </li> </ol>	



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	<ul style="list-style-type: none"> <li>2. <i>Commodity prices</i> <ul style="list-style-type: none"> <li>• <i>Steel</i></li> <li>• <i>Aluminum</i></li> <li>• <i>Diesel</i></li> <li>• <i>Concrete</i></li> <li>• <i>Copper</i></li> </ul> </li> <li>3. <i>Procurement and Construction</i> <ul style="list-style-type: none"> <li>• <i>Labor rates</i></li> <li>• <i>Weather</i></li> <li>• <i>Manufacturing capacity</i></li> <li>• <i>Design changes</i></li> <li>• <i>Availability of labor</i></li> </ul> </li> <li>4. <i>Subsurface Conditions</i> <ul style="list-style-type: none"> <li>• <i>Rock</i></li> <li>• <i>Artesian water pressure</i></li> <li>• <i>Manmade buried debris</i></li> <li>• <i>Hazardous waste</i></li> <li>• <i>Non-drillable boulders</i></li> <li>• <i>High water tables</i></li> </ul> </li> <li>5. <i>O&amp;M</i> <ul style="list-style-type: none"> <li>• <i>Labor rates</i></li> <li>• <i>Cost of transmission line components</i></li> <li>• <i>Component failure rates</i></li> <li>• <i>Vandalism and right-of-way dumping rates</i></li> <li>• <i>System operating conditions</i></li> <li>• <i>Changes in law</i></li> <li>• <i>Weather and catastrophic events</i></li> </ul> </li> </ul>	
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Fort McMurray Project Components Subject to Bid		
<p>The AESO seeks stakeholder comments, including advantages and disadvantages, on whether the stages of the project should be bid out as one project or whether each stage should be bid out separately.</p>		
Stakeholder	Stakeholder Comment	Replies
<p>LS Power</p>	<p><i>There are a number of advantages to bidding the project stages separately. While the project stages are similar in geography and scope there may be some developers that bring specific advantages to one stage that they don't bring to the other. This may include landowner relationships or other specific knowledge that reduces the pricing and risk. Further, if the project size becomes too large, there is a possibility that competitive pressures will decrease because the number of entities willing to take this level of risk may be small. In addition, contracting with multiple developers may reduce counterparty risk.</i></p> <p><i>One possible disadvantage to contracting the phases separately is the loss of economies of scale. As the project becomes larger, the developer has more buying power and can transition staff from one phase to the next. However, because the phases are spread out over time and they are relatively large in scope, LS Power does not believe the economy of scale disadvantage outweighs the advantages of bidding the phases separate.</i></p>	
Draft Recommendation Paper - Other Comments		
<p>Do stakeholders have any other comments regarding the Draft Recommendation Paper?</p>		
Stakeholder	Stakeholder Comment	Replies
<p>LS Power</p>		