



**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>2010-03-31</u> Period of Consultation: <u>∞</u> through 2010-04-28 Comments From: <u>TransAlta Corporation</u> Date [yyyy/mm/dd]: <u>2010-04-28</u>	Contact: <u>Kevin T Van Koughnett</u> Phone: <u>403-267-2063</u> E-mail: <u>kevin_van_koughnett@transalta.com</u>
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<b>Risk Sharing Options – Cost Recovery / Pricing Arrangements</b>
The AESO seeks stakeholder comments on other risk sharing options the AESO may consider for the AESO Own model.



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	Stakeholder Comment	
	<p><i>The options in most part cover the upfront portion of the costs.</i></p> <p><i>The other aspect is the term of the operating phase. We would suggest that transmission facilities have a very long life and even a term of 20 years is short. Perhaps a longer term of 25 or 30 years would also have some financing advantages allowing longer cost amortization and providing more investor certainty.</i></p> <p><i>Any contract should consider extensions at the end of term and the basis for such extensions through contractual language included for adjustment formulas and/or negotiations.</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><i>TransAlta assumes that as part of the long term planning and the CTI designation process that capital cost estimates are developed which in part are based on some review of possible routing options.</i></p> <p><i>If the AESO has in mind future area developments of facilities which may connect to the CTI project and which may influence routing then these should be indicated. Such considerations should be provided to the bidders.</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>The cost-of-service regulatory process covers risks by pass through to the tariff process to the ratepayer.</i></p> <p><i>A contractual model is entirely different and risks must be foreseen, estimated and included in a proposed payment schedule over the facility life cycle. For example, if adverse weather was to result in catastrophic destruction of numerous</i></p>	



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	<p><i>kilometers of line then the capital costs of restoration would be the responsibility of the facility owner. Such an owner would need to insure against such risks with an acceptable deductible and recover the premium costs of this insurance through the contract payments. The deductible would remain a risk and require a rate of return to cover this risk increase. The potential future cash calls may also lead to owners funding a reserve for such events and this may be required by lenders. Standard TFO practice is to self-insure in a regulatory model given the risks are borne by the ratepayer.</i></p> <p><i>Notwithstanding the above comments, it should not be interpreted that the overall life cycle costs of a competitive project would be more than if the project had been under traditional regulation. Directionally competitive processes have incentives which should lower the initial capital cost and the operating costs of the facilities and as such provide room to cover assumed risks.</i></p>	
<p><b>Fort McMurray Project Components Subject to Bid</b></p>		
<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>		



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	<p><i>We would suggest that 1A and 1B be combined as a single project. We would suggest separate bids for each project.</i></p> <p><i>Given the stated in service dates of the various projects being 2017/2019 and 2021 we are concerned of the ability of proponents to bid prices on work with such distant future in service dates. The second project is ten years in the future. Any bid would need to have numerous escalators to cover equipment, materials and labour costs so as to cover such risks for the bidder.</i></p>	
<b>Draft Recommendation Paper - Other Comments</b>		
Do stakeholders have any other comments regarding the Draft Recommendation Paper?		
Stakeholder	Stakeholder Comment	
<p>Given an incumbent TFO is eligible in Step 2, how does the AESO plan on ensuring that the preparation of the RFQ is not a cost to be recovered through the regulatory process and that such costs are at the risk of the shareholders of the TFO?</p> <p>The analogous process was that for the Purchase Power Arrangements (PPA) except that the facilities in question already existed. We would suggest that the AESO</p>	<p><i>TransAlta generally reiterates in the left column the comments made in the comment matrix submission of November 2010. We, in part, carry them forward given the generality of the provided responses.</i></p> <p><i>We believe that even with the OWN process there also needs to be included the concept of a default provider which would be the incumbent TFO(s) under the</i></p>	



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<p>study that process and inform themselves of the ongoing issues with substituting a long term contract in place of traditional regulation. It must be remembered that the PPA process was undertaken to deregulate generation.</p> <p>TransAlta believes it is important that the AESO is clear on the intent and likely outcomes of competitive procurement. Competitive Procurement is being advanced as a solution or remedy to a perceived problem and implicitly that perception is that the traditional approaches to transmission are not working. Is deregulation of the bulk transmission system the intent of the Competitive Procurement process?</p> <p>It should be expected that if the Selected Entity is to take on increased risks than a traditional TFO then the rate of return requirements will increase.</p> <p>We wonder how a TFO who has both traditionally regulated transmission and an “Own Contract” will ensure separation of their regulated and unregulated businesses.</p>	<p><i>traditional cost-of-service regulated model. The benchmark for competitive procurement is the results expected from the regulated model and competitive procurement must provide a better life cycle result than the default or benchmark approach.</i></p> <p><i>TransAlta asserts the Policy, Legislation and the AESO, as implementer of the Policy and Legislation, must be clear as to the problems which are to be remedied by a competitive process rather than the traditional regulatory process and which problems could not be dealt with by either modifications to the traditional regulatory process or by adherence to the tools already provided by the regulatory process.</i></p> <p><i>We were pleased during the April 14<sup>th</sup> information session to find out that the AESO contemplates providing a draft contract as part of the process as this will add certainty to the bid process and shorten and/or eliminate any negotiation process during final selection. We would further ask that this draft contract be made part of these consultations such that market participants may comment on it.</i></p>	
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<p>Financial engineering is stated as a key driver for cost minimization. This assertion was provided without proof or evidence. Project financing is more expensive than balance sheet financing and requires higher interest rates given the non-recourse nature of such financing. The AESO should provide information on the relative merits of financial engineering to the traditional rate approach.</p> <p>The risk sharing has to be designed not only on the development and construction phase but for the operational and maintenance phase for the transmission facilities. The tradeoffs between capital costs and operational costs must be considered.</p> <p>The creation of a contract which will be viable and fair over the 30 to 50 year life of transmission assets is challenging and time consuming. To expedite any process involving such a contract a draft contract will have to be provided to qualified bidders prior to bidding to allow pricing consistent with the terms and conditions of the contract and the risks and uncertainties inherent in a long term contract.</p>	<p><i>As well, during the information session it was indicated that consideration is being given as to how many proponents will be selected from the RFQ process to continue to the RFP process. We believe all qualified proponents should proceed to the RFP. The demonstrated capability and capacity of the proponent to obtain construction financing for non-regulated projects of the size and for the period required would appear to be an important selection criteria.</i></p>	
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<p>Implicit in structuring a “contract” outside of regulation which allows “financial engineering” is an underlying assessment that existing regulation and rates of return are deficient. Advocating such an approach is tantamount to deregulating transmission except for the routing approvals.</p> <p>The AESO and the DOE need to consider if bifurcation of transmission into coexisting regulated and unregulated facilities is prudent. If regulation is not producing the required outcomes then regulation needs to be changed rather than having carved out processes which may be both disruptive and counterproductive.</p> <p>Section 26 of the Transmission Regulation already requires that transmission facilities be constructed by “a TFO or other person” using competitive tenders. Is it the assessment that Section 26 is ineffective in obtaining competitive costs for transmission facilities and that a new process is required? If it is ineffective in that it does produce the desired results, then what needs to be done or changed so the process is effective?</p> <p>Prudence of capital expenditures must</p>		
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<p>compare the initial forecast cost estimate and the actual as-built capital costs. Such prudency testing may result in such capital cost increases either being disallowed or allowed a lower rate of return on the increased portion.</p>		
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