Attachment B

Michael Gorman Expert Report on Imputed Debt from NIPPC's Reply Comments in OPUC Docket No. UM 2255

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

In the Matter of **UM 2255**

IDAHO POWER COMPANY

Application for Approval of 2026 All-Source Request for Proposals to Meet 2026 Capacity Resource Need.

Expert Report

on PPA Imputed Debt

of

Michael P. Gorman, CFA

May 9, 2023

BRUBAKER & ASSOCIATES, INC.

Project 11472

My qualifications and experience to offer this expert report are summarized in the attached BAI corporate qualifications profile. This report responds to Idaho Power Company's ("the Company" or "Idaho Power") proposal to make an imputed debt adjustment to the cost of purchased power agreements and battery storage agreements (collectively referred to as PPAs) in the 2026 request for proposals ("RFP") bid evaluation process. This response was prepared on behalf of the Northwest & Intermountain Power Producers Coalition ("NIPPC"), and my conclusions support London Economics International's ("LEI") and the Oregon Public Utility Commission Staff's recommendation to reject Idaho Power's proposal to include an imputed debt adjustment to costs of non-utility resource bids (PPAs) for bid evaluation purposes.

An imputed debt adjustment to the cost of a PPA (generally an imputed debt cost adder) should be excluded from the RFP because such an imputed debt cost adder would create an economic bias against selecting PPAs as the most economic resource option. As outlined below, PPAs do have contractual financial obligations and do impose financial costs on utilities, including Idaho Power, to balance the leverage risk of resource options including PPAs. But importantly, non-PPA resources also cause financial costs related to the development, operating uncertainty, and financial risk associated with utility-owned resource options. Idaho Power has not proposed to reflect the added financial costs for the utility-owned resource options in its resource economic evaluation. Idaho Power's proposal is inconsistent and imbalanced. These added financial costs, if accurately measured for all resource options, would largely be offsetting between PPAs and utility-owned resources. Therefore, it is fair and accurate to simply not reflect these external, unknown financial costs in the comparison of resource options.

Additionally, as further detailed in this report, Idaho Power has exaggerated the debt equivalent and has overstated a debt imputation cost for PPAs, if one would be appropriate in isolation of other types of resources, which it is not.

Idaho Power's evidence does not support its proposal to include an imputed debt adder to the cost of a PPA in comparing the cost of various resource options in this RFP. However, if the Commission is interested in further examining PPA debt equivalence and capital structure management issues, Idaho Power could address the issue in Idaho Power's next rate case along with other aspects of its cost of capital and/or cost of service.

UTILITY RESOURCES ADDED COSTS

Idaho Power's Position on Debt Imputation and PPAs

Idaho Power outlines how a credit rating agency would assess its leverage risk in a utility credit rating assessment. It states that a PPA creates leverage which Idaho Power must manage by changing its capital structure's mix of debt and equity in funding utility-owned infrastructure investments in order to avoid a credit downgrade. Idaho Power suggests that it may need to increase its use of equity capital on utility rate base investments (reduced leverage risk) to balance the imputed debt equivalence of a PPA (increased leverage risk). Idaho Power asserts that this possible change to the ratemaking capital structure's equity component would increase Idaho Power's cost of service. Idaho Power maintains that the PPA imputed debt cost adder reflects the added cost to the utility's cost of service caused by the PPA. Further, Idaho Power contends that under new accounting standards, a PPA may, under certain circumstances, be regarded as an operating lease which would need to be recorded on its balance sheet as a regulatory liability.[1] Idaho Power claims that the increase

[1] Idaho Power's Reply Comments, p. 11 (March 24, 2023).

in this liability would also increase its leverage risk which would need to be considered in managing a balanced ratemaking capital structure.

Ultimately, Idaho Power asserts that the PPA would increase Idaho Power's leverage risk which would need to be balanced by increasing the percentage weight of common equity capital in the utility's ratemaking capital structure (an offset to the PPA leverage) to maintain a balanced amount of utility leverage which in turn will support its credit rating and access to capital.

Idaho Power cites credit rating methodologies used by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's") to support its claims.

Response

I do not dispute that credit rating agencies will consider a contractual obligation of the utility in an assessment of the overall leverage or financial risk of the utility and that may result in added costs to a utility's cost of service for added leverage risk. However, these added costs do not result only from PPAs but also result from added financial cost for utility-owned and utility-developed generating resource options. Idaho Power has ignored or has understated these financial costs for non-PPAs. A balanced review of these added leverage risk adjustments shows that the added financial costs for a PPA are similar to the added financial costs for utility-owned facilities. Hence, it is not fair, balanced, or accurate to consider only an imputed debt adjustment cost for a PPA resource option without any consideration of the added financial costs for a utility-owned resource option. Idaho Power's comparison creates a clear bias against the cost of PPA resource options and favoritism for utility-owned resources. It is more conservative and more accurate to set the added financial cost issue aside in a resource cost comparison such as RFP scoring, with the understanding that the utility will need to balance its financial obligations in order to maintain strong credit standing

while selecting resource options which reflect the best and most economic resource options available to the utility.

Again, I agree with Idaho Power's findings that credit rating agencies consider leverage risk for PPAs, but I do not agree with certain assertions Idaho Power makes concerning the magnitude of those PPA leverage risks. Specifically, I believe Idaho Power exaggerates the debt equivalents for a PPA in several aspects in its application for its approval of the 2026 RFP. In its reply comments, the Company states that Idaho Power currently has contractual obligations for cogeneration and power production contracts of more than $4 billion.[2] At pages 12 and 13 of the reply comments, it states that, as the Company transforms from a resource surplus position to a resource deficient position, the risk factor used by credit agencies in determining the debt-like equivalent of its PPAs will likely increase from a 25% factor up to a 50% factor. It states this will happen simply by consequence of moving from being capacity surplus to being capacity deficient. Further, at pages 11 and 13 of the reply comments, Idaho Power asserts that under new accounting standards, Idaho Power may need to record any PPA with dispatch rights as an operating lease and record the PPA on its balance sheet as a regulatory liability. Under this accounting, Idaho Power reports that the PPA would be given 100% imputed debt treatment by the credit rating agency.

Neither of these assertions hold up in a review of Idaho Power's credit rating metrics published by S&P. Specifically, Table 1 below contains S&P's published analysis of Idaho Power's leverage metrics and risk assessment, including the "off-balance sheet" debt equivalence S&P has attributed to Idaho Power's existing PPA obligations. As shown below in Table 1, the $4 billion in cogeneration and power production contracts noted by Idaho Power do not translate into a similar amount of off-balance sheet debt considered by S&P for Idaho Power's leverage risk assessment. Instead, the $4 billion of cogeneration and power

[2] *Id*., p. 7 (March 24, 2023).

production facilities referenced by Idaho Power's reply comments has resulted in an imputed debt equivalent from S&P of only $271 million in 2017-2019. For additional context, that $271 million of debt equivalent related to existing PPAs is relatively minor in relationship to the more than $2.0 billion of on-balance sheet debt. This shows that a PPA's debt equivalence is manageable for Idaho Power.

TABLE 1

Idaho Power Company

S&P Credit Rating Leverage Metrics
(Millions)

Description	3 yr avg	2017	2018	2019	2020	2021	2022
Balance Sheet Debt	$2,065	$1,746	$1,835	$1,837	$2,000	$2,001	$2,194
OLA Debt	0	35	0	0	0	0	0
Accessible cash and liquid investments	(112)	(45)	(165)	(99)	(166)	(60)	(109)
Purchase Power Debt Equivalent	0	271	271	271	0	0	0
ARO Debt Adjustment	27	21	21	22	22	29	30
Pension & Other Debt/Deferred Comp.	372	351	345	415	506	417	193
Total OBS	287	632	471	609	362	386	114
Total Debt: Balance Sheet Plus OBS	2,352	2,378	2,306	2,446	2,362	2,386	2,308

Source:
S&P Credit Stats, Idaho Power Company

Also of significance in S&P's leverage risk assessment is the off-balance sheet debt associated with asset retirement obligations ("ARO"), and the pension and other debt-deferred compensation issues. AROs can include the cost of decommissioning utility-owned resources and can include such items as coal ash pond remediation and other environmental cleanup costs. Pension off-balance sheet obligations include the utility's obligation to fully fund its pension trust fund to meet the retirement obligations of its employees. Credit rating agencies track these obligations because the costs can be material and reflect liabilities to the utility, much the same way PPAs can be contractual liabilities to the utility. As shown in Table 1 above, off-balance sheet debt obligations for AROs and pension obligations exceed the off-balance sheet debt obligations of PPAs.

Idaho Power Exaggerates PPA Debt Equivalency Impacts

Further, Idaho Power's argument that the risk factor for converting PPA capacity payments to debt equivalents will increase materially as it transitions from being a capacity surplus utility to a capacity deficient utility is also not consistent with S&P's reports regarding its risk assessment method for calculating a PPA's debt equivalent.[3] NIPPC asked Idaho Power to provide copies of its communications with credit rating agencies to confirm its representations of the PPA debt equivalence assertions. In response, Idaho Power stated that its communications with credit agencies were oral, and it did not have written material from the credit agencies.[4]

Idaho Power's characterization of the oral communications with credit agencies concerning PPA debt equivalency risk factor adjustments do not align with S&P's published reports that explain its PPA debt equivalence methodology used in the utility credit rating process. Once again, S&P uses a risk factor in its debt imputation for PPAs by considering the utility's expected capacity payments under the PPA, and converts that into a debt equivalent using a risk factor. In S&P's published report that describes its debt imputation for PPAs used in utility credit rating leverage assessments, S&P describes the risk factor adjustment to PPA capacity payments as follows:

> Risk Factors
>
> The NPVs that Standard & Poor's calculates to adjust reported financial metrics to capture PPA capacity payments are multiplied by risk factors. These risk factors typically range between 0% to 50%, but can be as high as 100%. Risk factors are inversely related to the strength and availability of regulatory or legislative vehicles for the recovery of the capacity costs associated with power supply arrangements. The strongest recovery mechanisms translate into the smallest risk factors. A 100% risk factor would signify that all risk related to contractual obligations rests on the company with no mitigating regulatory or legislative support.[5]

[3] Idaho Power's Reply Comments, pp. 12-13 (March 24, 2023).
[4] Idaho Power's Response to NIPPC's Information Request No. 3.
[5] *Standard & Poor's Ratings*: "Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements," at 2 (May 7, 2007) (emphasis added).

At page 5 of this same report, S&P describes its debt equivalency adjustment if a PPA is treated as an operating lease. S&P will still apply the risk factor adjustment in determining the PPA's debt equivalent. Idaho Power claims that if the PPA is recorded as a lease liability, the PPA would be treated as the equivalent of long-term debt.[6] However, that assertion is not consistent with S&P's published methodology, which states S&P would still use its risk factor adjustment for a PPA recorded as a lease liability to gauge its debt equivalence. S&P stated as follows:

> Several utilities have reported that their accountants dictate that certain PPAs need to be treated as leases for accounting purposes due to the tenor of the PPA or the residual value of the asset upon the PPA's expiration. We have consistently taken the position that companies should identify those capacity charges that are subject to operating lease treatment in the financial statements so that we can accord PPA treatment to those obligations, in lieu of lease treatment. That is, PPAs that receive operating lease treatment for accounting purposes won't be subject to a 100% risk factor for analytical purposes as though they were leases. Rather, the NPV of the stream of capacity payments associated with these PPAs will be reduced by the risk factor that is applied to the utility's other PPA commitments. PPAs that are treated as capital leases for accounting purposes will not receive PPA treatment because capital lease treatment indicates that the plant under contract economically "belongs" to the utility.[7]

While debt equivalence of a PPA in an assessment of a utility's credit risk is not in dispute, Idaho Power's claimed magnitude of the debt equivalence is exaggerated. Specifically, Idaho Power has claimed that its risk factor would increase from 25% to 50% due to change of its resource position from surplus to deficient. This assumption is not supported by S&P's methodology for assigning a risk factor for purposes of an imputed debt calculation. By making this assumption, Idaho Power has increased by double the amount of debt equivalency of expected PPAs. This overstates the cost of a PPA debt equivalency adjustment and is not consistent with a reasonable estimate of the financial leverage impact on Idaho Power's cost of service.

[6] Idaho Power's Reply Comments, p. 11 (March 24, 2023).
[7] *Id*. at 5 (emphasis added).

Idaho Power's Debt Equivalence Risk Factor Adjustments for PPAs is Flawed

In its debt equivalency methodology, Idaho Power states that it is assigning a risk factor of 50%, an increase from the current PPA risk factor of 25%, to judge the debt equivalence of a PPA cost and to adjust PPA costs in its resource cost comparison.[8] Idaho Power maintains that the risk factor used by credit rating agencies to determine the PPA debt equivalence, at least with respect to its Public Utility Regulatory Policies Act of 1978 ("PURPA") contracts, was a 25% risk factor but the Company expects that to increase to 50% because the Company is moving from a capacity surplus position, to a capacity deficient position.[9] The Company has used a 50% risk factor in its quantification of a PPA embedded debt estimate in its last RFP, and plans to do so again in this RFP.[10] Idaho Power states that in its last RFP this methodology resulted in a bid adder with a median magnitude of 18% for the imputed debt for the PPA bids, when measured as a percentage of overall levelized revenue requirement for the bid.[11] Again, Idaho Power's debt equivalency is exaggerated and imbalanced.

There are several flaws in Idaho Power's adjustments. First, Idaho Power states the risk factor adjustment should be increased because it is moving from a capacity surplus to a capacity deficient position, and this increased need for capacity will increase the PPA risk factor in calculating its debt equivalent. However, S&P's published methodologies do not support this assumption. Rather, as quoted above, S&P's debt equivalency risk factor is more impacted by the cost recovery mechanisms in place for the utility's recovery of the costs it must pay to the seller under the PPA, and not Idaho Power's capacity surplus or deficiency position.

Second, Idaho Power's assumption that new accounting standards may result in a PPA being regarded as an operating lease and recorded as a regulatory liability on its balance sheet, which would be treated by credit rating agencies as long-term debt, is also not

[8] Idaho Power's Reply Comments, pp. 12-13 (March 24, 2023).
[9] *Id*.
[10] *Id*.; Idaho Power's Response to NIPPC's Information Request No. 1(c).
[11] Idaho Power's Response to NIPPC's Information Request No. 1(a).

supported. S&P states that it will continue to make a risk factor adjustment to a lease obligation in assessing the PPA's off-balance debt equivalence. Rate recovery mechanisms make a significant impact on Idaho Power's credit risk attributable to a PPA.

The debt risk of a utility-owned facility is considerably greater than that of a PPA because under a PPA a third-party supplier, in whole or at least in great part, assumes the operating risk of the resource used to provide capacity and energy to Idaho Power. Comparing a PPA to a utility-owned facility, if the resource fails to operate as expected, under a PPA, Idaho Power can terminate capacity and energy payments to the third-party supplier if they fail to deliver capacity and energy to Idaho Power.[12] This ability to terminate fixed capacity payments to a PPA reduces its debt equivalence attributed by the credit rating agency. In contrast, with a utility-owned facility, the credit rating agency will consider the risk that a utility will develop a facility which fails to operate, in which case the utility will continue to be obligated to make debt service payments for debt it took to finance this facility, or other infrastructure investments, irrespective of whether or not the utility-owned facility actually operates as planned. In this instance, the utility would both be obligated to make debt service payments on the generation resource option it developed and owns, plus it would be obligated to go to the market to buy replacement power costs.

Further, Idaho Power acknowledges its cost recovery mechanisms for a PPA may be different than those for a utility-owned facility. Idaho Power states that a utility-owned facility typically would be recovered in the utility's rate case, and recovered through traditional tariff rates. However, a PPA may be subject to the Company's Power Cost Adjustment Mechanism ("PCAM"). The Company states in a discovery response, that its PCAM reflects an actual cost reconciliation relative to the forecast costs, and variances outside of a symmetrical bandwidth are subject to recovery or refund to customers.[13] This reconciliation factor within the PCAM

[12] Idaho Power's Response to NIPPC's Information Request No. 10.
[13] *Id*.

transfers most of the cost recovery risk of a PPA to customers, and thus reduces the debt-like nature of the PPA in the credit rating process. Hence, credit rating agencies recognize if a utility has less cost recovery risk under a PPA due to the regulatory mechanisms which provide the utility greater assurance of full cost recovery, those cost recovery assurances mitigate the debt-like nature of a PPA compared to utility-owned resources, and would reduce Idaho Power's leverage risk for a PPA relative to a utility-owned resource.

Because Idaho Power's recovery mechanisms for PPA costs are not changing, there is no legitimate reason to assume that the PPA debt equivalent will increase by adjusting the risk factor from 25% as it currently exists up to 50%, as Idaho Power proposes. Hence, Idaho Power's debt equivalency adder for a PPA is not only imbalanced and unfair, but it is also intentionally exaggerated in amount.

Utility-Owned Financial Leverage Cost Adjustments

Idaho Power's proposal to include a PPA leverage cost adjustment to fully account for the cost of PPAs is not balanced by making similar financial leverage cost adjustments to reflect additional leverage costs associated with utility-owned resources.

Utility-owned resources have investment and operating risks that are greater than those inherent in a PPA, in which case the third party assumes the investment and operating risks. For example, a PPA has far less financial risk to the utility compared to utility-owned facilities for the following reasons:

1. A PPA poses little or no cash flow constraints on the utility while the resource is initially being developed. Indeed, Idaho Power acknowledges that under a PPA, it typically would not pay for the capacity and energy from the unit until the unit is actually able to provide capacity and energy to Idaho Power.

2. For a utility self-build project, the utility can go through a period of cash deficiency in the resource development stage if, prior to the unit being placed in service and providing service to customers, the resource cost is not included in tariff rates. This cash stress period during development can also impact the utility's financial leverage and generally could result in the utility increasing the equity ratio of its

ratemaking capital structure to accommodate the weak cash flow experienced during the development of a utility-owned resource. The utility cash flow would not be stressed during the development of a PPA resource.

3. The PPA exposes the utility to less asset risk than a utility-owned facility. Specifically, if a PPA failed to operate sufficiently and did not provide capacity and energy, then the utility may not be obligated to pay capacity and energy payments to a third-party supplier under the PPA. In some instances, Idaho Power acknowledges that the third-party supplier may be liable to Idaho Power for replacement capacity and energy costs if it failed to perform under the PPA.[14] Also, to the extent there is significant prolonged damage to the resources underlying a PPA, Idaho Power may be able to declare the third-party supplier to be in default and can cancel its financial obligations under a PPA.[15] The utility may be largely protected from resource failure under a PPA but not under utility ownership.

4. Under a utility-ownership scenario, the utility has full asset risk for the generating resource, and will still be obligated to make debt service payments for the funding used to develop or acquire the utility-owned resource even if it has a catastrophic event which removes the resource from public service and precludes full recovery of the utility's costs and outstanding debt from ratepayers.

These resource asset development and operating risks would be considered by credit rating agencies in developing the overall leverage risk and financial risk of Idaho Power in a credit rating review. These risks are unique to utility-owned resources, which Idaho Power would need to manage in balancing a capital structure to maintain its financial integrity and investment grade credit standing. These are all financial costs associated with utility-owned resources which would not be risks or costs incurred under a PPA. Ignoring these utility-owned financial costs to manage development and operating risks as an offset to the PPA debt equivalent renders Idaho Power's proposed cost comparison of the various resources inexact, imbalanced, and biased against PPA bids in the RFP.

Idaho Power's proposal to include a PPA debt equivalence adder as part of a PPA's cost in an economic comparison of various resource options should be denied.

[14] Idaho Power's Response to NIPPC's Information Request No. 9.
[15] *Id*.

Michael Gorman

Areas of Expertise

Competitive Procurement
Competitive Energy Procurement
Price Forecasts
Risk Management
Supplier Management

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Alternative/Incentive Regulatory Plans/Mechanisms
Cost of Service
Electric Fuel and Gas Cost Reviews and Rates
Marginal Cost Analysis
Nuclear Decommissioning Costs
Performance Based Rates
Prudence and Used/Useful Evaluation
Rate Design and Tariff Analysis
Storage Cost/Necessity

Financial
Asset /Enterprise Valuation
Cost of Capital
Depreciation Studies
Financial Integrity
Merger Evaluations (Benefit/Costs)
Revenue Requirement Issues

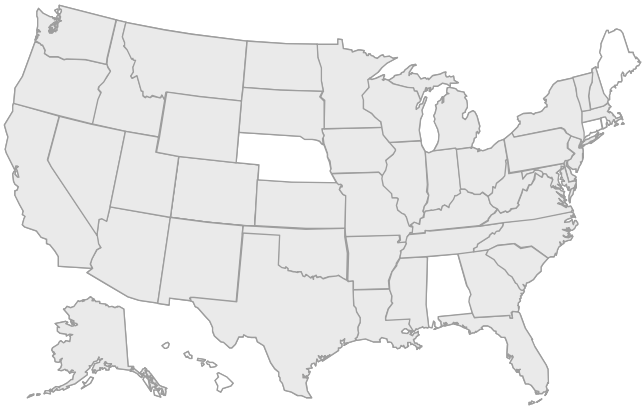
Special Projects
Site Selection and Evaluation
Training Seminars

Mr. Gorman is a Managing Principal at BAI. He received Degrees of Bachelor of Science in Electrical Engineering from Southern Illinois University at Carbondale and Master of Business Administration from the University of Illinois at Springfield. Mr. Gorman has also done extensive graduate studies in Financial Economics. He earned the designation Chartered Financial Analyst (CFA) from the CFA Institute.

Mr. Gorman has been in the consulting practice since 1990, and in the energy business since 1983. Mr. Gorman was employed by the Illinois Commerce Commission and held positions including Director of the Financial Analysis Department, Senior Analyst, Planning Analyst and Utility Engineer. Mr. Gorman was also employed by Merrill Lynch as a Financial Consultant. In this position, he consulted on cash management and investment strategies.

His responsibilities at BAI include project management, cost of capital studies, depreciation studies, financial integrity studies, system resource planning studies, alternative regulation plan/mechanisms, cost of service, rate design, production cost evaluations, commodity risk management, commodity procurement management, competitive supplier management and counterparty credit risk.

Project Work



Other Project Work

- Alberta
- Board of Public Utilities of Kansas City, Kansas
- City of Austin Electric Utility Council
- Federal Energy Regulatory Commission (FERC)
- LaGrange, Georgia / Municipal Electric Authority of Georgia
- Newfoundland
- Nova Scotia
- Salt River Project