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MEMORANDUM

Arizona Corporation Commission

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AZ CORP COMMISSION  
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TO: THE COMMISSION

FROM: Utilities Division

DATE: January 23, 2004

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RE: IN THE MATTER OF THE CONTINUATION OF THE SCHEDULED INCREASE OF THE PORTFOLIO PERCENTAGE SPECIFIED IN A.A.C. R14-2-1618 B. OF THE ENVIRONMENTAL PORTFOLIO STANDARD RULES (DOCKET NO. RE-00000C-00-0377)

On February 8, 2001, the Arizona Corporation Commission ("Commission") entered Decision No. 63364 adopting the Environmental Portfolio Standard Rules, Arizona Administrative Code ("A.A.C.") R14-2-1618. On March 29, 2001, the Commission entered Decision No. 63486, in response to requests for rehearing and reconsideration to modify Decision No. 63364.

The portfolio percentage is described in A.A.C. R14-2-1618 B. 1. of the Environmental Portfolio Standard Rules. The percentage started at .2 percent in 2001, increasing annually by .2 percent through 2005. The percentage will increase to 1.05 percent in 2006 and to 1.1 percent in 2007. The percentage will remain at 1.1 percent through 2012.

A.A.C. R14-2-1618 B.2. required that the scheduled annual increase in the portfolio percentage would continue after December 31, 2004, only if the cost of environmental portfolio electricity had declined to a Commission-approved cost/benefit point.

A.A.C. R14-2-1618 B.2. also required the Director of the Utilities Division to establish an Environmental Portfolio Cost Evaluation Working Group not later than January 1, 2003. The Environmental Portfolio Cost Evaluation Working Group was tasked to make recommendations to the Commission of an acceptable portfolio electricity cost/benefit point or portfolio kWh cost impact maximum. The rules required that the Working Group provide its recommendations to the Commission not later than June 30, 2003.

The Environmental Portfolio Cost Evaluation Working Group was established in September 2002 and continued to meet through June 2003. The Working Group's Final Report, "Costs, Benefits, and Impacts of the Arizona Environmental Portfolio Standard," which included the group's recommendations, was submitted to the Commission on June 30, 2003.

On October 6, 2003, the Commission Staff and Environmental Portfolio Cost Evaluation Working Group members presented a Cost Evaluation Working Group Workshop & Special Open Meeting that described the group's recommendations.

The recommendations of the Cost Evaluation Working Group (CEWG) are:

1. The CEWG recommends that the Commission use the Portfolio net simple cost premium number of \$0.11 per kWh, defined in the Recommendations section of the CEWG Final Report, as a reference point or benchmark for evaluating future costs and cost reductions resulting from the Environmental Portfolio Standard. This net simple cost premium may be used by the Commission as a general benchmark to evaluate in the aggregate the future progress in achieving cost reductions in solar photovoltaic projects by the Load Serving Entities as a result of their efforts to comply with the goals of the Environmental Portfolio Standard Rules. It should be noted, however, that this net simple cost premium is based on a set of assumptions and the current funding method of the projects. As noted in the Recommendations section, to the extent the assumptions change, the benchmark would have to be adjusted for items such as financing or operating costs.
2. The CEWG recommends that the Commission recognize that considerable progress has been made in just 18 months and that the Environmental Portfolio Standard should be continued with two possible options:
  - Option 1: Take no action at this time and leave the annual renewable energy target at 0.8 percent of retail energy sales for all Load Serving Entities until a future review determines that either Environmental Portfolio Standard funding is sufficient, or solar generation costs have declined to the point for Environmental Portfolio Standard program success for all Load Serving Entities at the 0.8 percent level, then increase the program percentage to 1.1 percent.
  - Option 2: Continue the renewable energy requirement increase to 1.1 percent by 2007.

Staff participated in the Environmental Portfolio Cost Evaluation Working Group meetings and prepared the Final Report of the Working Group for submission to the Commission. Staff believes that the Portfolio net simple cost premium number of \$0.11 per kWh is a reasonable cost-benefit point for the Commission to use as the criterion for the decision to continue the scheduled annual increase in the portfolio percentage. The Cost Evaluation Working Group Final Report showed that the cost of Portfolio electricity has declined significantly since the original Solar Portfolio Standard was established in 1996. The data for 2001-2002 indicate this decrease is continuing.

THE COMMISSION

January 23, 2004

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In addition to the work of the Environmental Portfolio Cost Evaluation Working Group, Staff is aware of a number of developers of potential solar, wind, and biomass projects that are actively discussing those future projects with Arizona utilities. The addition of these new projects to Arizona's generation mix will increase the low-cost renewable kWhs available to utilities to meet their Portfolio requirements.

Staff has reviewed Option 1 and finds that its suggestion of a "future review" sends entirely the wrong message about the portfolio standard. Staff has heard evidence from renewable developers that utilities in 2001-2003 were declining to enter into contracts for Portfolio kWhs until after the Cost Evaluation Working Group Final Report was submitted. The reason given was that the Commission might change its mind or direction of the Portfolio Standard as a result of the report. To establish yet another "future review" target only promotes the excuse to delay portfolio decisions. Staff does not recommend adoption of Option 1.

Staff recommends that the Commission select Option 2, continuing the scheduled increase in the portfolio percentage, as specified in the Environmental Portfolio Standard Rules, A.A.C. R14-2-1618 B.1.

Staff recommends that the Commission approve the Portfolio net simple cost premium number of \$0.11 per kWh, which is defined in the Recommendations section of the Cost Evaluation Working Group Final Report, as a reasonable cost-benefit point for the Commission to use as the criterion for the decision to continue the scheduled annual increase in the portfolio percentage



Ernest G. Johnson  
Director  
Utilities Division

EGJ:RTW:BEK:lhm\JFW

ORIGINATOR: Ray T. Williamson and Barbara Keene

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Chairman
- WILLIAM A. MUNDELL  
Commissioner
- JEFF HATCH-MILLER  
Commissioner
- MIKE GLEASON  
Commissioner
- KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE  
CONTINUATION OF THE SCHEDULED  
INCREASE OF THE PORTFOLIO  
PERCENTAGE SPECIFIED IN A.A.C.  
R14-2-1618 B. OF THE ENVIRONMENTAL  
PORTFOLIO STANDARD RULES

DOCKET NO. RE-00000C-00-0377  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
February 10 and 11, 2004  
Phoenix, Arizona

FINDINGS OF FACT

1. On February 8, 2001, the Commission entered Decision No. 63364 adopting the Environmental Portfolio Standard Rules, Arizona Administrative Code ("A.A.C.") R14-2-1618.
2. On March 29, 2001, the Commission entered Decision No. 63486, in response to requests for rehearing and reconsideration to modify Decision No. 63364.
3. The portfolio percentage is described in A.A.C. R14-2-1618 B. 1. of the Environmental Portfolio Standard Rules. The percentage started at .2 percent in 2001, increasing annually by .2 percent through 2005. The percentage will increase to 1.05 percent in 2006 and to 1.1 percent in 2007. The percentage will remain at 1.1 percent through 2012.
4. A.A.C. R14-2-1618 B.2. required that the scheduled annual increase in the portfolio percentage would continue after December 31, 2004, only if the cost of environmental portfolio electricity had declined to a Commission-approved cost/benefit point.
5. A.A.C. R14-2-1618 B. 2. also required the Director of the Utilities Division to establish an Environmental Portfolio Cost Evaluation Working Group not later than January 1,

1 2003. The Environmental Portfolio Cost Evaluation Working Group was tasked to make  
2 recommendations to the Commission of an acceptable portfolio electricity cost/benefit point or  
3 portfolio kWh cost impact maximum. The rules required that the Working Group provide its  
4 recommendations to the Commission not later than June 30, 2003.

5 6. The Environmental Portfolio Cost Evaluation Working Group was established in  
6 September 2002 and continued to meet through June 2003. The Working Group's Final Report,  
7 "Costs, Benefits, and Impacts of the Arizona Environmental Portfolio Standard," which included  
8 the group's recommendations, was submitted to the Commission on June 30, 2003.

9 7. On October 6, 2003, the Commission Staff and Environmental Portfolio Cost  
10 Evaluation Working Group members presented a Cost Evaluation Working Group Workshop &  
11 Special Open Meeting that described the group's recommendations.

12 8. The recommendations of the Cost Evaluation Working Group ("CEWG") are:

13 a. The CEWG recommends that the Commission use the Portfolio net  
14 simple cost premium number of \$0.11 per kWh, defined in the  
15 Recommendations section of the CEWG Final Report, as a  
16 reference point or benchmark for evaluating future costs and cost  
17 reductions resulting from the Environmental Portfolio Standard.  
18 This net simple cost premium may be used by the Commission as a  
19 general benchmark to evaluate in the aggregate the future progress  
20 in achieving cost reductions in solar photovoltaic projects by the  
21 Load Serving Entities as a result of their efforts to comply with the  
22 goals of the Environmental Portfolio Standard Rules. It should be  
23 noted, however, that this net simple cost premium is based on a set  
24 of assumptions and the current funding method of the projects. As  
25 noted in the Recommendations section, to the extent the  
26 assumptions change, the benchmark would have to be adjusted for  
27 items such as financing or operating costs.

28 b. The CEWG recommends that the Commission recognize that  
considerable progress has been made in just 18 months and that the  
Environmental Portfolio Standard should be continued with two  
possible options:

- Option 1: Take no action at this time and leave the annual renewable energy target at 0.8 percent of retail energy sales for all Load Serving Entities until a future review determines that either Environmental Portfolio Standard funding is sufficient, or solar generation costs have declined to the point for Environmental Portfolio Standard program success for all

1 Load Serving Entities at the 0.8 percent level, then increase  
2 the program percentage to 1.1 percent.

- 3 • Option 2: Continue the renewable energy requirement  
4 increase to 1.1 percent by 2007.

5 9. Staff participated in the Environmental Portfolio Cost Evaluation Working Group  
6 meetings and prepared the Final Report of the Working Group for submission to the Commission.  
7 Staff believes that the Portfolio net simple cost premium number of \$0.11 per kWh is a reasonable  
8 cost-benefit point for the Commission to use as the criterion for the decision to continue the  
9 scheduled annual increase in the portfolio percentage.

10 10. The Cost Evaluation Working Group Final Report showed that the cost of Portfolio  
11 electricity has declined significantly since the original Solar Portfolio Standard was established in  
12 1996. The data for 2001-2002 indicate this decrease is continuing.

13 11. In addition to the work of the Environmental Portfolio Cost Evaluation Working  
14 Group, Staff is aware of a number of developers of potential solar, wind, and biomass projects that  
15 are actively discussing those future projects with Arizona utilities. The addition of these new  
16 projects to Arizona's generation mix will increase the low-cost renewable kWhs available to  
17 utilities to meet their Portfolio requirements.

18 12. Staff has reviewed Option 1 and has found that its suggestion of a "future review"  
19 sends entirely the wrong message about the portfolio standard. Staff has heard evidence from  
20 renewable developers that utilities in 2001-2003 were declining to enter into contracts for Portfolio  
21 kWhs until after the Cost Evaluation Working Group Final Report was submitted. The reason  
22 given was that the Commission might change its mind or direction of the Portfolio Standard as a  
23 result of the report. Staff believes that establishing yet another "future review" target only  
24 promotes the excuse to delay portfolio decisions until after the future review.

25 13. Staff has not recommended approval of Option 1.

26 14. Staff has recommended that the Commission approve Option 2, continuing the  
27 scheduled annual increase in the portfolio percentage, as specified in the Environmental Portfolio  
28 Standard Rules.





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