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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

MARC SPITZER, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
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Arizona Corporation Commission

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FEB 05 2004

AZ CORP COMMISSION
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IN THE MATTER OF THE CONTINUATION
OF THE SCHEDULED INCREASE OF THE
PORTFOLIO PERCENTAGE SPECIFIED IN
R14-2-1618 B OF THE ENVIRONMENTAL
PORTFOLIO STANDARD RULES.

DOCKET NO. RE-00000C-00-0377

**COMMENTS OF ARIZONA PUBLIC SERVICE COMPANY
TO STAFF MEMORANDUM AND RECOMMENDED ORDER**

Arizona Public Service Company ("APS" or "Company") hereby submits these
Comments to the Staff Memorandum and Recommended Order ("Staff
Recommendation") in the above-captioned proceeding addressing the Environmental
Portfolio Standard ("EPS") and the Cost Evaluation Working Group's ("CEWG") June
30, 2003 Final Report.

I. INTRODUCTION

APS supports the continuation of an EPS and believes that an EPS ultimately will
provide long-term benefits to Arizona. The current EPS has helped APS and other
Arizona utilities gain valuable experience in installing renewable capacity and has helped
make Arizona a national leader in the development of solar energy installations. APS also
generally supports the CEWG's Final Report. Although consensus was not reached on
every statement or recommendation in the Report, there was substantial consensus
reached among the participants both on major policy issues and on the progress achieved
to date.

1 Indeed, one should not misread either the Staff Memorandum or these Comments
2 to suggest that there is significant divergence between members of the CEWG on the
3 major policy issues considered by that group, because there is not. However, APS believes
4 that it is premature to decide at this time whether the EPS's renewable energy target of 0.8
5 percent should increase to 1.1 percent by 2007, given the Final Report's conclusion that
6 the current funding levels for the EPS are inadequate to achieve that target by 2007 and
7 prior to a series of workshops this Spring that are intended to both address the funding
8 shortfall and the design of the EPS itself. Thus, APS recommends that the Commission
9 wait to determine how to move forward with the EPS until after it has the information and
10 recommendations developed in those workshops.

11 **II. IT IS PREMATURE TO DECIDE ON EITHER OPTION 1 OR OPTION 2**
12 **UNTIL THE WORKSHOPS THIS SPRING HAVE CONCLUDED**

13 In its comments to the CEWG Final Report, APS stated that it could support either
14 Option 1 (remain at 0.8 percent) or Option 2 (increase to 1.1 percent).¹ More specifically,
15 APS supports an increase in the EPS goal to 1.1 percent if the Commission remedies the
16 lack of funding that at present prevents any Arizona utility from meeting the EPS under
17 the current schedule, or if the EPS is modified to adjust the resource mix or schedule in a
18 manner that provides a realistic opportunity to meet the standard. In fact, APS believes
19 that relatively modest changes to the funding, resource mix and schedule of the EPS
20 would allow a renewable energy target of significantly more than 1.1 percent of energy.
21 These potential changes, including funding for the EPS, are to be addressed in workshops
22 this Spring. By waiting until after these workshops, the Commission will be in a better
23 position to assess how to move forward with the EPS. And, given Staff's recommendation
24 in APS' pending rate case (Docket No. E-01345A-03-0437) to increase EPS funding by
25 only \$4.4 million—an amount still significantly below what is needed to meet the EPS

26 ¹ APS construes Option 2, as described in the Staff Memorandum, to consist solely of the increase
in the EPS to 1.1 percent.

1 goals—waiting for the workshops to address modifications to the EPS is even more
2 necessary.

3 The Staff Recommendation also characterizes Option 1 as threatening the EPS
4 because it recommends a future review which Staff believes will only promote excuses to
5 delay EPS decisions. Such an assertion is incorrect. Option 1 would continue the EPS, but
6 at its current goal of 0.8 percent of energy. The future review under Option 1 would not be
7 a review to determine whether to continue the EPS, but only a decision on how to proceed
8 with the EPS. APS believes that future periodic review of progress under the EPS is as
9 appropriate and prudent today (under either Option 1 or Option 2) as it was when the EPS
10 was first adopted, and will help ensure that in return for customer subsidization of
11 technology that is not currently cost-effective, the solar industry attains the future price
12 decreases they have promised this Commission.

13 If the Commission determines that it is necessary to select an option at this time,
14 leaving the EPS at its current level will not affect utility decisions on how to use the
15 present EPS funding. That is because at current funding levels and with the current
16 restrictions in the EPS for non-solar renewable technologies, neither the 0.8 percent or 1.1
17 percent goal will be reached by 2007. APS is concerned that under the current EPS
18 standards and funding levels, a decision at this time to increase in the EPS to 1.1 percent
19 by 2007 would be at best symbolic, and at worst will create unrealistic expectations of
20 what can and will be accomplished in the way of implementing renewable resources.
21 Selecting Option 1 also would not prevent the Commission from later raising the
22 percentage goal once the factors preventing achievement of the 0.8 percent goal have been
23 addressed. Contrary to Staff's assertions, it is the continued existence of these factors
24 rather than the extent of the EPS goal that causes uncertainty about the EPS' future
25 viability.

26

1 But the Commission need not choose between Option 1 and Option 2 at this time.
2 Rule 1618(B)(2) provides that the EPS will continue to increase after December 31, 2004
3 only if the cost of renewable electricity under the EPS has declined to the cost-benefit
4 point established by the Commission. Thus, the Commission can act at any time this year
5 to establish the cost-benefit point. Given the workshops that have already been scheduled
6 for this Spring on the EPS, the Commission should wait until it has the results of those
7 workshops before deciding how to move forward with the EPS. These workshops should
8 address key issues with the EPS including the resource mix, funding levels, and schedule.
9 The number, scope and participation in those scheduled workshops make it highly
10 unlikely that such a delay would be perceived by anyone as a retreat on the EPS,
11 especially if there is a firm commitment to take action based on such workshops. APS'
12 proposed Amendment No. 1 addresses this issue. APS' proposed amendments assume that
13 the Commission determines that an order is appropriate at this time. The Commission
14 could simply hold over a decision on this matter until after the workshops scheduled for
15 this Spring.

16 **III. THE CURRENT STATUS OF EPS FUNDING SHOULD BE EXPRESSLY**
17 **RECOGNIZED IN THE COMMISSION'S FINAL ORDER**

18 Of particular concern to APS is the absence in the Staff Recommendation of any
19 discussion on the presently inadequate funding to meet the EPS goals. In Decision No.
20 63364 (February 8, 2001), p. 4, the Commission stated "[i]t is the intent of this Rule that
21 the surcharge will cover the cost of the mandate." The Final Report, however, concludes
22 that "there are not sufficient funds, based on current costs of solar generation, to meet the
23 [EPS goals]." (Report at p. 47.) Thus, there was a very broad consensus in the CEWG that
24 the current funding for the EPS was not sufficient to allow utilities to meet the standard
25 under the current timeframes or with the current solar-intense resource mix of the EPS.
26

1 The current lack of adequate funding for the EPS is not the fault of the utilities or
2 of the renewables industry, and the CEWG Final Report specifically concludes that “TEP
3 and APS have acted carefully in the selection, design, installation, and operation of their
4 renewable generation resources, and have reasonably managed EPS financial resources.”
5 (CEWG Final Report at p. 48.) The inability to reach the present target of 0.8 percent is
6 simply the result of limitations inherent in the current funding levels, the resource mix
7 required by the current rule, and the schedule of the EPS. Each of these limitations should
8 be addressed in workshops this Spring, further supporting a delay until after the
9 workshops to determine how to proceed on increasing the EPS goals.

10 Despite the clear consensus on such a core issue affecting the implementation of
11 the EPS, the Staff Recommendation makes no mention of the lack of sufficient funding to
12 meet the EPS goals. If the Commission concludes it necessary to select an option now, the
13 Commission should expressly recognize that the funding for the EPS is at present
14 insufficient to permit compliance with the current standard under the existing schedule.
15 APS’ proposed Amendment No. 2 recognizes the current funding limitations and provides
16 that the increase to 1.1 percent will be implemented contingent on the resolution of such
17 funding issues at the workshops this Spring.

18 **IV. THE 11 CENTS PER KWH COST PREMIUM IS NOT A USEFUL COST** 19 **BENEFIT POINT FOR FUTURE CONSIDERATION**

20 The Staff Recommendation proposes a “net simple cost” premium of 11 cents per
21 kWh as a reasonable “cost-benefit point” for the Commission to adopt as the criterion for
22 determining whether to increase the EPS goal from 0.8 percent. This recommendation
23 does not reflect the conclusions of the CEWG regarding the 11 cents per kWh figure and
24 could raise unnecessary confusion as to the cost-effectiveness of future EPS projects. It is
25 also unnecessary to satisfy Rule 1618(B)(2). Instead of attempting to define a single
26 “premium” figure that by its own definition only applies in limited circumstances and

1 using a very limiting set of assumptions, APS recommends that the Commission simply
2 conclude that the cost of solar installations have declined by over 25 percent since 1997,
3 and that this reduction is itself a sufficient positive response to warrant continuation of the
4 EPS. (See Final Report, Section III.)

5 Specifically, the CEWG concluded that the 11 cent premium² was a reasonable
6 approximation of the extent to which costs for photovoltaic projects under the EPS
7 exceeded an attempted quantification of benefits for such projects installed through 2002,
8 given a number of assumptions and ignoring several additional costs that would result
9 under different funding scenarios. The 11 cents per kWh premium figure was meant
10 merely as a benchmark to evaluate, in a relative sense, future progress of the photovoltaic
11 industry under the EPS. It was not intended to represent the actual expected premium for
12 future photovoltaic projects under the EPS because the assumptions and additional costs
13 that were ignored are critical in evaluating the true costs of any future projects.

14 In fact, because the 11 cent premium is a “simple” cost premium, it is essentially
15 meaningless in determining whether or if any projects can satisfy a commercial payback
16 analysis. For example, the Final Report recommends that utilities consider long-term
17 purchase agreements for renewable resources. Any project financing or long-term
18 contract, however, would require the consideration of carrying costs (interest, taxes, etc.),
19 O&M expenses, and market and technology uncertainties, all of which were expressly
20 ignored in establishing the 11 cents per kWh cost-benefit premium figure. The cost
21 premium associated with such a long-term contract would likely be more than double the
22 11 cents per kWh simple premium determined in the CEWG Final Report. Thus, it would

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25 ² Although the Staff Recommendation characterizes the 11 cent premium as a “cost-benefit” point,
26 it is not a cost-benefit figure in the traditional sense of being a point at which costs equal quantifiable
benefits. Instead, the 11 cent figure means that the current cost of solar photovoltaic technology is 11 cents
per kWh above all quantifiable benefits and assuming only a simple payback scenario.

1 be unreasonable to expect utilities to install photovoltaic projects in the future only when
2 they meet or beat this "cost-benefit" figure.

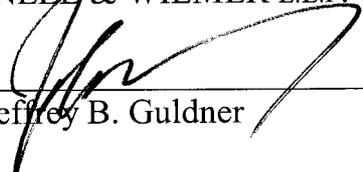
3 Again, APS believes that the Commission should, instead, conclude that the
4 roughly 25 percent decline in the costs of solar installations is an acceptable cost-benefit
5 point to continue the EPS program, and recognize that the 11 cent per kWh simple cost
6 figure determined by the CEWG may be used as a reference point or benchmark for
7 evaluating future costs and cost reductions. APS' proposed Amendment No. 3 clarifies the
8 nature of the 11 cents per kWh premium and also the cost-benefit point referenced in the
9 rule.

10 **V. CONCLUSION**

11 APS continues to support the EPS and believes that an EPS standard should
12 continue. APS also supports either Option 1 or increasing the EPS goal to 1.1 percent as
13 scheduled if the current lack of funding is addressed. However, APS believes that it is
14 premature for the Commission to decide which option to implement at this time, and
15 recommends that the decision await the completion of workshops relating to the EPS
16 scheduled for this Spring. Those workshops will allow the Commission to make a more
17 informed decision on the structure and goals of the EPS. They could potentially lead to a
18 more robust EPS than would result from what would be a purely symbolic increase in the
19 EPS standard given the uncontroverted evidence that the present funding levels for the
20 EPS are too low to allow any utility to meet the EPS goals on time.

21 RESPECTFULLY SUBMITTED this 5th day of February 2004.

22 SNELL & WILMER L.L.P.

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25 Jeffrey B. Guldner
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PINNACLE WEST CAPITAL CORP.
Law Department


Thomas L. Mumaw
Karilee Ramaley

Attorneys for Arizona Public Service Company

Original and 21 copies of the foregoing
filed this 5th day of February 2004, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Copies of the foregoing mailed, faxed or
transmitted electronically this 5th
day of February 2004, to:

All parties of record


Vicki DiCola

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**ARIZONA PUBLIC SERVICE COMPANY'S
PROPOSED AMENDMENT NO. 1
TO RECOMMENDED ORDER
(FUTURE EPS WORKSHOPS)**

TIME/DATE PREPARED: February 4, 2004

COMPANY: In the Matter of the Environmental AGENDA ITEM NO. U-____
Portfolio Standard Increase

DOCKET NO. RE-00000C-00-0377

OPEN MEETING DATE: February 10, 2004

Page 3, Line 18 to Page 4, Line 3:

DELETE Findings of Fact Nos. 12 - 15

INSERT New Finding of Fact - "A series of workshops have been scheduled over the next several months to address the Environmental Portfolio Standard. Those workshops will include consideration of the resource mix, funding levels, and schedule for the Environmental Portfolio Standard."

INSERT New Finding of Fact - "These workshops will provide additional information that may inform the decision on how to move forward with the Environmental Portfolio Standard. Accordingly, it is appropriate to delay the decision on whether to implement the scheduled annual increase in the portfolio percentage until after these workshops."

Page 4, Lines 9-10

DELETE "...that it is in the public interest to approve and adopt Staff's recommendations."

INSERT "...that it is appropriate to consider the information from the forthcoming workshops on the Environmental Portfolio Standard prior to making the determination of whether to implement the scheduled annual increase in the portfolio percentage."

Page 4, Lines 11-13

DELETE Conclusion of Law No. 3.

Page 4, Lines 15-20:

DELETE ordering paragraphs.

INSERT new ordering paragraph - "THEREFORE, IT IS ORDERED that Staff supplement the Staff Memorandum dated January 23, 2004 after the workshops on the Environmental Portfolio Standard are completed to report to the Commission the results of those workshops and the recommendations of Staff."

Page 5, Lines 1-3

DELETE ordering paragraph.

**ARIZONA PUBLIC SERVICE COMPANY'S
PROPOSED AMENDMENT NO. 2
TO RECOMMENDED ORDER
(EPS FUNDING)**

TIME/DATE PREPARED: February 4, 2004

COMPANY: In the Matter of the Environmental AGENDA ITEM NO. U-____
Portfolio Standard Increase

DOCKET NO. RE-00000C-00-0377

OPEN MEETING DATE: February 10, 2004

Page 3, Line 13:

INSERT new Finding of Fact - "Although costs of Portfolio electricity are declining, the current funding for the Environmental Portfolio Standard is insufficient to permit the utilities to meet the Environmental Portfolio Standard under the schedule currently in Rule 1618."

INSERT new Finding of Fact - "The forthcoming workshops on Environmental Portfolio Standard this Spring should address methods for resolving this funding shortfall."

Page 4, Line 1:

INSERT new Finding of Fact - "Option 2, as defined in Finding of Fact No. 8, should only be implemented if there is sufficient funding to allow the utilities to meet the increased portfolio percentages under the schedule set forth in Rule 1618."

Page 4, Line 10:

INSERT at the end of the paragraph - "as modified herein."

Page 4, Line 18:

INSERT new ordering paragraph - "IT IS FURTHER ORDERED that because the current funding for the Environmental Portfolio Standard is insufficient to permit the utilities to meet the portfolio percentages under the schedule set forth in Rule 1618, Staff shall address methods for resolving this funding shortfall in the forthcoming workshops on the Environmental Portfolio Standard and report to the Commission the results of those workshops and the recommendations of Staff."

Page 4, Line 20:

INSERT at the end of the paragraph - "provided that there is sufficient funding to allow the utilities to meet the increased portfolio percentages under the schedule set forth in Rule 1618 or as the Environmental Portfolio Standard is modified in the forthcoming workshops."

**ARIZONA PUBLIC SERVICE COMPANY'S
PROPOSED AMENDMENT NO. 2
TO RECOMMENDED ORDER
(COST-BENEFIT POINT)**

TIME/DATE PREPARED: February 4, 2004

COMPANY: In the Matter of the Environmental AGENDA ITEM NO. U-____
Portfolio Standard Increase

DOCKET NO. RE-00000C-00-0377

OPEN MEETING DATE: February 10, 2004

Page 3, Lines 7-9:

DELETE from "Staff believes that..." to "...the portfolio percentage."

Page 3, Lines 10-12:

DELETE Finding of Fact No. 10.

INSERT new Finding of Fact - "The Final Report of the Working Group shows that costs for solar installations have declined by roughly 25 percent from 1997 through 2002. The data for 2001-2002 indicate that this decrease is continuing. Such a decrease should serve as the cost-benefit point under Rule 1618(B)(2)."

Page 4, Lines 1-3:

DELETE Finding of Fact No. 15.

INSERT new Finding of Fact - "The net simple cost premium number of \$0.11 per kWh should be used as a reference point or benchmark for evaluating future costs and cost reductions of solar photovoltaic projects. The premium should be adjusted to address changed assumptions that were not considered when this number was developed."

Page 4, Line 10:

INSERT at the end of the paragraph - "as modified herein."

Page 4, Lines 15-17:

DELETE "the Portfolio net..." to "...Final Report"

INSERT "the decline in cost of solar photovoltaic installations of roughly 25 percent from 1997 through 2002"

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