ORIGINAL NEW APPLICATION

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E-01345A-09-0263

IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR AUTHORIZATION FOR INCREASE IN RECOVERY GUARANTEE FOR PRODUCTION BASED INCENTIVES FOR DISTRIBUTED RENEWABLE GENERATION PROJECTS	DOCKET NO. E-01345A-09-_____ **APPLICATION** **Expedited Treatment Requested**

Arizona Corporation Commission
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On December 18, 2008, the Arizona Corporation Commission ("Commission") issued Decision No. 70654, which approved Arizona Public Service Company's ("APS" or "Company") 2009 Renewable Energy Standard Implementation Plan. In that Decision, the Commission approved recovery of the costs of incentive payments that the Company will incur to meet APS's obligation for Production Based Incentives ("PBI") that are paid to customers for non-residential distributed renewable energy projects. The Commission approved cost recovery for all contracts entered into with customers, up to a maximum of $77 million over the lifetime of the contract.[1]

In this filing, the Company is requesting that the Commission increase the $77 million PBI amount by $143 million (for a total of $220 million) to accommodate increasing customer demand that supports APS's compliance with the non-residential portion of the distributed energy component of the Renewable Energy Standard and Tariff ("REST") Rules.[2] The increase in the amount of cost recovery guarantee will not impact customers' bills in 2009, because many of these large renewable projects will not be operational this

[1] Decision No. 70654 at pg. 12.
[2] A.A.C. R14-2-1805.

year, and those that will operate in 2009 will only have been operational for a short period of time.[3] Without Commission action, the APS non-residential PBI program will be unable to continue to take reservations for these distributed energy projects. For that reason, the Company is requesting that the Commission make its determination on this matter on an expedited basis.

BACKGROUND

The REST Rules require that electric utilities meet an annual renewable energy requirement, of which a certain percentage must be provided from distributed renewable energy resources.[4] The Commission has approved two types of incentives that APS may use to encourage customers to install distributed energy systems. Residential customers are paid up-front incentives. Small scale non-residential renewable systems may also receive up-front incentives, but large scale non-residential renewable systems that are eligible for incentives greater than $75,000 receive a PBI, an incentive based on system energy output. Unlike the up-front incentives, which are paid out in a single year, the PBI commits the Company to making quarterly payments to the non-residential customer for a period of between 10 and 20 years. This filing addresses only the PBI incentives.

For large-scale distributed projects, a customer will request in advance of system installation that APS reserve funding to pay incentives once the system is operational. These transactions can be complex: APS must review and approve the customer proposal, and the customer must often obtain financing, as well as engage a renewable energy installer to construct the system. Because it can take many months before the system is actually producing electricity, a customer can reserve funds up to one year before commissioning the system. Therefore, reservations for funding that the Company accepts in 2009 may not be paid out until 2010. Likewise, this delay between the time of the reservation request and

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[3] PBIs are paid to the customer based on actual system production; therefore, while considerable capacity will be added or committed to in 2009, only a relatively small number of kilowatt hours ("kWh") of energy will actually be produced, for which customers will receive an inventive payment.

[4] A.A.C. R14-2-1804 requires that APS obtain 2.00% of renewable energy in 2009, and 2.50% in 2010. In addition, in 2009, 15% of that renewable energy must be obtained through distributed renewable energy; that percentage increases to 20% in 2010. A.A.C. R14-2-1805.

actual operations of the renewable system requires the Company to take into consideration the REST distributed requirements for the future years, in order to assure compliance with the rules.

As noted above, the PBI incentives are paid to customers over time pursuant to contracts, which are known as Credit Purchase Agreements ("CPAs"). In the past, APS had included a "Change in Law Provision" in its CPAs, which was a contractual provision that addressed the possibility that future changes in law may affect provisions of the CPAs to the detriment of either party. As the Commission recognized in Decision No. 70654, there is risk involving renewable energy systems that receive PBIs because the transaction extends into the future and could be affected by a change in law.[5] The Commission also recognized that the uncertainty regarding PBI payments as well as the inclusion of a Change in Law Provision in the Company's CPAs may negatively affect renewable projects and may cause customers to have difficulty in obtaining financing for the projects. To address these concerns and to moot the need for a change in law provision, the Commission approved cost recovery of the PBI obligations that APS incurs for all CPAs entered into up to $77 million.[6]

NEED TO INCREASE THE $77 MILLION PBI CAP

During the deliberations that resulted in Decision No. 70654, APS anticipated at that time the $77 million cap for cost recovery of PBIs would be adequate to provide PBIs to non-residential customers through all of 2009. The $77 million in cumulative lifetime PBI commitments for 2009 included in APS's 2009 Implementation Plan was modeled based on a variety of assumptions, including a diversified resource mix, and varying terms of the PBI contracts. In 2009, APS has seen a stronger than expected number of reservations for non-residential systems,[7] and the vast majority of non-residential customer interest is for the

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[5] Decision No. 70654 at pg. 9.

[6] *Id.*

[7] Thirty-seven new reservations were received for the nomination period ending April 29, 2009; the large majority were received in the last week of the nomination period. Each nomination period represents a two-month window during which customers can request incentive funding. After close of the nomination period, the projects are prioritized based on the Rank Calculator described in APS's Distributed Energy Administration Plan. Projects are affirmed or denied a reservation in the two weeks following each nomination period.

installation of photovoltaic systems[8] which qualify for the PBI payments. As a result of the surge in customer requests for PBI reservations, the $77 million dollar cap on PBI is now insufficient for APS to be able to support the number and type of distributed energy projects that customers are pursuing under APS's 2009 Renewable Energy Incentive Program. With a cap of $77 million, the Company cannot accept all the reservations it has received, and will be unable to accept any further reservations until the Commission makes a determination on this application.

Upon receiving the unprecedented volume of requests, APS undertook extensive analysis and modeling to forecast anticipated incentive demand based on the current environment. The Company has updated its assumptions, including a resource mix that is more heavily weighted towards PV systems, and varied lengths of time for CPAs to better reflect expected requests for the remainder of the year.[9] APS regularly communicates with customers interested in these large renewable systems and has attempted to quantify reservation requests that could be received in the near future. Based on this analysis, the Company has determined that to pay PBI incentives for all currently approved reservations, to accept all pending reservations, and to provide accommodations for the expected market demand through the end of 2009 (which includes systems that will be installed in 2010), APS will need Commission authorization for cost recovery of an additional $143 million (for a total authorized amount of $220 million). APS believes that the requested increased authorization would allow APS to approve sufficient reservations to support customer interest in distributed energy through 2009, and will allow sufficient installations necessary to meet both the 2009 and 2010 REST non-residential distributed energy requirements.

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[8] PBIs for photovoltaic systems are the most costly incentives, as compared to other eligible distributed energy technologies. A higher proportion of photovoltaic reservation requests results in a higher total PBI commitment than would otherwise result, had customers chosen to install variety of eligible renewable technology applications.

[9] These contracts can have terms of ten years and twenty years, and the payment of PBIs can vary. The Company has contracts that are for ten years and twenty years, and the PBIs are paid for that same period. There is also a "hybrid" ten-year contract which pairs 10 years of PBI payments with a 20-year Renewable Energy Credit agreement. In Decision No. 70654, the Commission specifically determined that APS should not eliminate the latter option at that time. *See* pg. 10.

Because PBIs are paid based on system production, and because many of the systems reserving funding will not be operational until late in 2009 or in 2010, APS believes the funding available for 2009 production payments is sufficient under the current RES adjustor. In APS's upcoming implementation plan to be filed July 1, 2009, the Company will present a 5-year forecast for distributed renewable activity, identify associated PBI commitment requirements, and identify funding requirements.

The implementation plan will also incorporate the Company's outstanding Distributed Energy Request for Proposal, which should result in the Company being able to acquire non-residential distributed energy systems at an incentive cost that is dramatically lower than the standard RES incentive levels. These projects would allow APS to meet non-residential compliance well into the future, and APS will provide the necessary information so that the Commission can give the option fair consideration.

CONCLUSION

The unexpected increase in non-residential requests for incentives to support large-scale solar PV installations provides a strong signal that APS customers are increasingly committing to using renewable resources to meet part of their energy requirements. APS believes this is a very good sign supportive of the Commission's RES program. APS believes that it is in the public interest to increase the PBI cap to accommodate an additional amount of $143 million for PBI payments. Given that many of these requests are being made to the Company now, APS also requests that the Commission take action in an expedited manner, so the implementation of distributed energy resources for non-residential customers can continue this year.

RESPECTFULLY SUBMITTED this 26th day of May, 2009.

PINNACLE WEST CAPITAL CORPORATION
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