OPEN MEETING

ORIGINAL

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: August 11, 2009

RE: 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-09-0263)

The Arizona Corporation Commission ("Commission") approved the Arizona Public Service Company's ("APS") 2009 Renewable Energy Standard Implementation Plan on December 18, 2008, in Decision No. 70654. As part of that Decision, the Commission approved the recovery of the costs of Production Based Incentives ("PBI") paid to non-residential customers with distributed renewable energy projects. The Commission approved cost recovery for all PBI contracts entered into with APS customers, up to a maximum dollar amount of $77 million over the lifetime of the contracts after APS removed the "change in law provision" from its contracts.

APS has, in this filing, requested that the Commission increase the PBI recovery guarantee to $220 million in order to fund the increasing demand for PBI incentives. This new demand will allow APS to comply with the non-residential portion of the distributed energy component of the Renewable Energy Standard and Tariff ("REST") Rules.

APS asserts that the increase in the cost recovery guarantee will not have any impact on the bills of APS' customers in 2009. Commission Staff ("Staff") concurs with this APS assertion.

APS submitted the following table in response to an informal data request from Staff:

Production Based Incentive Cap Analysis – Projected Through the End of 2009				
Project Type	Number of Projects	kWdc[1]	Annual Incentive Impact	Lifetime Contract Commitment
Reserved & Installed[2]	57	15,600	$ 6,200,000	$ 72,000,000
Received & Pending[3]	16	14,500	$ 3,800,000	$ 55,000,000
In Development[4]	5-10	12,000	$ 4,000,000	$ 63,000,000
Anticipated Based on Inquiries[5]	5-15	6,000	$ 2,000,000	$ 30,000,000
Total	**83-98**	**48,100**	**$16,000,000**	**$220,000,000**

[1] The kWdc figure relates to the name-plate output of the PV system in direct current ("dc")
[2] Projects have been accepted and/or completed
[3] New reservations through the April 30, 2008 nomination period
[4] APS has been involved in detailed project discussions with customers and developers.
[5] Forecasted based on informational inquiries from customers or developers

APS indicates that without any action by the Commission on this matter, APS will be unable to continue taking reservations for non-residential PBI projects beyond the $77 million cost recovery guarantee. Staff assumes that APS will not continue to take reservations beyond the $77 million guarantee because of its previous agreement to remove the "change in law provision" from its contracts.

On July 30, 2009, APS filed a supplemental filing in this docket. APS stated in its filing that it would like to pursue non-residential distributed energy beyond the REST compliance requirements.

APS indicated that there is increased interest in PBI reservation requests from schools at the same time that residential distributed project interest is lagging. APS proposes to offer schools an option in addition to the traditional PBI approach. APS proposes that school projects be classified as residential distributed energy projects, which would allow schools to receive up-front incentives paid by REST funding that had been allocated for residential projects. The energy derived by the school systems would apply to the residential distributed energy REST requirement.

APS contends that it will not be able to fund the anticipated influx of school projects without this reallocation of funding and redefinition of residential distributed energy projects.

Background

The APS REST Implementation Plan offers two types of incentives: one-time Up-Front Incentives ("UFI") and quarterly Production Based Incentives.

The UFI incentives are offered only to residential and small-sized non-residential renewable energy systems.

In 2008, when the Commission approved the $77 million recovery guarantee cap, APS believed, based on assumptions of the mixture of technologies that would be included in projects, that the $77 million cap would be sufficient for systems in 2009. However, in early 2009, APS saw a significant increase in requests for reservations for non-residential systems. The vast majority of these requests were for photovoltaic ("PV") systems. The PBI incentive for PV systems is the highest incentive offered by APS. This rapid influx of PV projects has tripled the size of the recovery guarantee needed. APS has stated that it believes that the requested $220 million guarantee will allow APS to sign contracts with enough projects to meet both the 2009 and 2010 REST non-residential distributed energy requirements.

On June 25, 2009, the Solar Alliance filed comments in this docket concerning APS' request for an increase in the recovery guarantee. The Solar Alliance recommends that there be no cap on the recovery guarantee. The Solar Alliance believes that the Commission's approval of PBI incentive levels and annual budgets that include the cost of PBI payments constitute "de facto approval of utility PBI payments."

On August 7, 2009, SunRun, Inc. ("SunRun") filed comments in the docket. SunRun also filed a request to intervene in the docket. SunRun's comments included SunRun's belief that the Commission should consider APS' request to increase the cost recovery guarantee to $220 million for PBI incentives.

SunRun also recommended that the Commission reject the APS request to reclassify school projects as residential. SunRun further recommended against the transfer of residential funding to non-residential programs. SunRun pointed out that residential solar sales in the second half of the year are typically about 50 percent higher than the first half of the year.

On August 10, 2009, the Solar Alliance docketed a second letter with comments concerning the APS filing of supplemental comments. The primary concern of the Solar Alliance is that too much of the residential funding would be diverted to schools, which would cause a shortage of residential project funds at the end of the year. The Solar Alliance recommends that, should the Commission decide to re-allocate funds, the re-allocation should be limited to $10 million. The Solar Alliance also recommends that the Renewable Energy Credits from schools not be counted toward the REST residential requirements. In addition, the Solar Alliance recommends that such a re-allocation should be done on a temporary, one-time basis without permanent reclassification of schools as residential. Finally, the Solar Alliance recommends that, to increase activity in the residential market, the Commission should increase the incentive cap for Up-front Incentives from the current 50 percent of total system cost to 60 percent of total system cost.

History of Incentive Levels

As the REST Rule development process took place in the 2004-2006 timeframe, the Arizona Solar Energy Industry Association ("AriSEIA") docketed one incentive plan that recommended incentives that would encourage distributed energy projects. A key component of that incentive proposal was that the incentive levels would drop by 10 percent each year.

In 2007, when APS filed its 2008 REST Plan, the incentives offered were to be constant for 2008 and 2009 and then drop by 10 percent in 2010. This approach was approved by the Commission. However, in 2008, when APS filed its 2009 REST Plan, APS decided not to propose a drop in incentives in 2010. Instead, APS proposed keeping the incentive levels constant for 2008, 2009, and 2010, followed by a 10 percent drop in 2011.

Staff Analysis

Staff has reviewed the APS Production Based Incentive Project Cap Analysis that is included in this document. This analysis projects a total of 48.1 MegaWatts ("MW") of new PBI projects that could receive APS commitments by the end of 2009, if the Commission approves the new $220 million recovery guarantee cap.

Staff analysis shows that if this 48.1 MW of new projects operate at a 20 percent capacity factor, a total of 84,271,200 kWh will be produced each year from the new projects. This number is greater than the non-residential distributed REST requirement (75,213,000 kWh) in 2010. Staff believes that the APS claim that the projects now in the queue would be enough to meet the 2009 and 2010 non-residential distributed energy requirements is correct.

Staff believes, based on its analysis of the APS projections, that the increase in the recovery guarantee to $220 million is justified in order for APS to meet its 2009 and 2010 non-residential distributed REST requirement.

Staff has reviewed APS' supplemental filing and agrees with APS that a reallocation of funding and redefinition of residential distributed energy systems to include schools will allow for more distributed energy projects to be installed in 2009 and 2010. The decision to make such a change is a policy call related to the allocation of REST requirements for distributed energy applications.

Staff has reviewed SunRun's comments. Staff points out that according to reports on the APS website, only 23 percent of the residential incentive budget for 2009 had been spent or reserved by June 30, 2009. That amount is $11,416,626 of the residential budget of $49,300,000.

Staff points out that, using SunRun's comments about the second half of the year being 50 percent higher than the first, the historical trend suggests that only $17-18 million in additional residential projects will be reserved in the second half of 2009. If one subtracts $18 million from the remaining $37,883,284, the amount likely to be unused at the end of 2009 is approximately $19.8 million. Even if the residential sales **doubled** in the second half (to $22,833,253), there would likely be $15 million of unused residential funding on December 31.

Staff has reviewed the comments of The Solar Alliance. Staff agrees that a mechanism to ensure that residential funding does not run out before year end might be comforting. There are many possible solutions to this dilemma. One solution would be for the Commission to re-allocate $10 million to schools at the August Open Meeting. This would leave approximately $27 million for residential projects. Then on October 1, 2009, APS could be allowed to re-allocate up to 40 percent of the unreserved residential funds to schools. Finally, on December 1, 2009, APS could be allowed to re-allocate 40 percent of the still unreserved funds. However, Staff believes this is unnecessary due to the balance remaining in the residential incentive buget.

Staff agrees with The Solar Alliance that this re-allocation should be on a temporary, one-time basis. Any school projects funded through the re-allocation of 2009 funds would be counted toward the residential requirements for the life of each school project. This procedure would not be repeated again in the future without Commission approval.

Staff's analysis of The Solar Alliance's incentive cap increase shows that such an increase would have the opposite effect of what was intended. Instead of **increasing** the number of residential solar systems installed, it would actually **reduce** the number of systems installed. An illustrative example shows this unintended consequence:

> If there is $10 million available for residential projects, and the average total system cost is $10,000, the incentive with the current 50 percent cap will be $5,000 per system. However, under the Solar Alliance's proposed 60 percent cap, that same system will receive a $6,000 incentive. So, for $10 million under the 50 percent cap, APS will fund 2,000 solar systems ($10 million / $5,000 per system).

However, under the proposed 60 percent cap, APS will only be able to fund 1,666 systems, a **reduction** of 334 systems.

Staff Concerns and Comments

Staff has developed concerns about the significant increased demand for non-residential photovoltaic PBI incentives. Staff believes that the recent rush to apply for incentives may be the result of four factors:

1. Because of the recession, many schools and local governments are facing severe budget problems. The installation of new solar systems could save a city or school districts enough on monthly electricity to avoid the furlough or lay-off of a number of teachers or employees.

2. Federal stimulus money is now available for renewable projects, but "shovel ready" projects are expected to be operational by the end of 2010.

3. The incentive level for PV projects is too high, causing a rush by the PV industry to install projects while incentives remain high.

4. Due to the recession, demand for PV panels is lower than anticipated in the world-wide market. This has created an excess supply of PV panels and a lower than expected demand for PV panels, thereby significantly reducing the world price for PV panels. Due to this lower panel price, solar developers see the APS PV PBI incentive of 18 – 25 cents/kWh as a profit bonanza while the incentives are still high.

Staff disagrees with the comments of Solar Alliance that no cap is necessary on the recovery guarantee. Just in the last eight months, since the Commission approved the APS 2009 REST Plan in Decision No. 70654, the estimate of the recovery guarantee has grown from $77 million to over $220 million. This increase is due to the unanticipated influx of photovoltaic system PBI incentive requests. At currently proposed incentive levels and without such a cap, the recovery guarantee could easily grow to $0.5 billion in 2010 and to $1 billion or more in 2011.

Staff's Suggestions Related to Concerns

Staff believes that if, in 2009 alone, APS can contract with enough projects to meet two years of REST requirements, it could well afford to lower its incentives for PV PBI projects in 2010 to levels that were originally scheduled, in the APS 2008 REST Plan, to be offered in 2010.

Currently, APS plans to offer its 2008 and 2009 incentive for PV PBI systems in 2010: 25 cents per kWh for 10-year contract / 20-year PBI incentive, 20.2 cents per kWh for 10-year contracts, 18.7 cents per kWh for 15-year contracts, and 18 cents per kWh for 20-year contracts.

Since the vast majority of renewable projects that have been submitted to APS are for photovoltaic projects and the incentives for PV projects are significantly higher than the incentives for most other renewable technologies, the incentive levels for PV drive the recovery guarantee numbers. For instance, if the annual output for the 48.1 MW of new projects is 84,271,200 kWh as calculated by Staff, a 1.8 cent per kWh reduction in the PV PBI for 20-year contracts from 18 cents per kWh to 16.2 cents per kWh would save APS $1.5 million per year or $30.33 million over 20 years for the same number of kWh.

At a public meeting with the renewable industry on June 2, 2009, APS announced the overall results of its 2008 Request for Proposal ("RFP") for Distributed Energy Resources. APS indicated that the costs per kWh resulting from the bids in the RFP were significantly lower than the proposals submitted as part of the normal non-residential reservation process.

Staff is concerned that the normal non-residential PBI process is offering much higher incentives for PV systems than are necessary to encourage robust participation in the REST program. If PBI incentives were lowered, for PV systems only, to the level originally planned for 2010 (in the APS 2008 REST plan), more PV projects could be funded and more renewable kWh could be produced for the same amount of money expended.

Finally, Staff believes that in the normal non-residential PBI reservation process, any project developer should be allowed to submit a proposal offering to accept an incentive **lower** than the incentive in the approved REST Plan. If such an offer is made, APS should consider such a project on a priority basis before others that are asking for the published incentive and, if the project meets all other APS criteria, APS should contract with the lower incentive project before considering higher incentive projects.

Staff Recommendations

Staff recommends approval of the APS request for an increase in the PBI incentive recovery guarantee to $220 million, under the following conditions:

1. APS shall modify the photovoltaic non-residential (grid-tied) incentive in its proposed 2010 REST Plan to: 22.5 cents per kWh (from 25 cents) for a 10-year contract / 20-year PBI incentive, 18.2 cents per kWh (from 20.2 cents) for a 10-year contract, 16.8 cents per kWh (from 18.7 cents) for a 15-year contract, and 16.2 cents per kWh (from 18 cents) for a 20-year contract. All other REST incentives will remain the same.

2. Any project developer shall be allowed, in the APS non-residential PBI reservation process, to offer to accept an incentive that is **lower** than the published incentive. If such an offer is made, APS shall consider such a project on a priority basis before others that are asking for the published incentive and, if the project meets all other APS criteria, APS shall contract with the lower incentive project before considering higher incentive projects.

3. Any PV PBI proposal, received after June 30, 2009, shall only be considered for the modified 2010 PV PBI incentive, as required in these conditions.

If the Commission chooses to approve the changes requested by APS in the supplemental filing (i.e., clarifying school projects as residential), Staff suggests that the following two ordering paragraphs be inserted into the Recommended Opinion and Order on Page 9 at Line 8.

IT IS FURTHER ORDERED that Arizona Public Service Company shall modify the Administration Section of its currently approved 2009 Renewable Energy Standard and Tariff Plan to reflect the following changes for 2009 funds only:

- Arizona Public Service Company is authorized to reallocate up to $20 million of the 2009 Renewable Energy Standard and Tariff residential distributed energy funding to the funding of school projects. If school projects have exhausted the $20 million allocation and additional residential funds remain unexpended and unreserved at the end of the year (December 31, 2009), additional school projects may be funded up to the total residential funds remaining.

- Residential requests for incentives will continue to be processed on a first-come, first-served basis up to the total amount of residential funds available, less any commitments made to schools.

- School projects shall be provided an up-front incentive of $2.25 per watt on a first-come, first-served basis.

- The current maximum up-front incentive cap of $75,000 is waived for schools.

- The renewable energy and associated Renewable Energy Credits from school projects shall be counted toward compliance with the Renewable Energy Standard and Tariff residential distributed energy requirement.

IT IS FURTHER ORDERED that Arizona Public Service Company shall make a compliance filing within 15 days which includes the modification of the Arizona Public Service Company 2009 Renewable Energy Standard and Tariff Plan and procedures as required herein.

Steven M. Olea
Director
Utilities Division

SMO:RTW:lhm\CH

ORIGINATOR: Ray Williamson

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

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-09-0263 DECISION NO. ________ ORDER

Open Meeting
August 25 and 26, 2009
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS" or "the Company") is certificated to provide electricity as a public service corporation in the State of Arizona.

2. The Arizona Corporation Commission ("Commission") approved APS' 2009 Renewable Energy Standard Implementation Plan on December 18, 2008, in Decision No. 70654. As part of that Decision, the Commission approved the recovery of the costs of Production Based Incentives ("PBI") paid to non-residential customers with distributed renewable energy projects.

3. The Commission approved cost recovery for all PBI contracts entered into with APS customers, up to a maximum dollar amount of $77 million over the lifetime of the contracts after APS removed the "change in law provision" from its contracts.

4. APS has, in this filing, requested that the Commission increase the PBI recovery guarantee to $220 million in order to fund the increasing demand for PBI incentives. This new

demand will allow APS to comply with the non-residential portion of the distributed energy component of the Renewable Energy Standard and Tariff ("REST") Rules.

5. APS asserts that the increase in the cost recovery guarantee will not have any impact on the bills of APS' customers in 2009. Commission Staff ("Staff") concurs with this APS assertion.

6. APS submitted the following table in response to an informal data request from Staff:

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Project Type	Number of Projects	kWdc[1]	Annual Incentive Impact	Lifetime Contract Commitment
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Total	**83-98**	**48,100**	**$16,000,000**	**$220,000,000**

7. APS indicates that without any action by the Commission on this matter, APS will be unable to continue taking reservations for non-residential PBI projects beyond the $77 million cost recovery guarantee. Staff assumes that APS will not continue to take reservations beyond the $77 million guarantee because of its previous agreement to remove the "change in law provision" from its contracts.

8. On July 30, 2009, APS filed a supplemental filing in this docket. APS stated in its filing that it would like to pursue non-residential distributed energy beyond the REST compliance requirements.

9. APS indicated that there is increased interest in PBI reservation requests from schools at the same time that residential distributed project interest is lagging. APS proposes to offer schools an option in addition to the traditional PBI approach. APS proposes that school projects be classified as residential distributed energy projects, which would allow schools to

[1] The kWdc figure relates to the name-plate output of the PV system in direct current ("dc")
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receive up-front incentives paid by REST funding that had been allocated for residential projects. The energy derived by the school systems would apply to the residential distributed energy REST requirement.

10. APS contends that it will not be able to fund the anticipated influx of school projects without this reallocation of funding and redefinition of residential distributed energy projects.

Background

11. The APS REST Implementation Plan offers two types of incentives: one-time Up-Front Incentives ("UFI") and quarterly Production Based Incentives.

12. The UFI incentives are offered only to residential and small-sized non-residential renewable energy systems.

13. In 2008, when the Commission approved the $77 million recovery guarantee cap, APS believed, based on assumptions of the mixture of technologies that would be included in projects, that the $77 million cap would be sufficient for systems in 2009. However, in early 2009, APS saw a significant increase in requests for reservations for non-residential systems. The vast majority of these requests were for photovoltaic ("PV") systems. The PBI incentive for PV systems is the highest incentive offered by APS. This rapid influx of PV projects has tripled the size of the recovery guarantee needed. APS has stated that it believes that the requested $220 million guarantee will allow APS to sign contracts with enough projects to meet both the 2009 and 2010 REST non-residential distributed energy requirements.

14. On June 25, 2009, the Solar Alliance filed comments in this docket concerning APS' request for an increase in the recovery guarantee. The Solar Alliance recommends that there be no cap on the recovery guarantee. The Solar Alliance believes that the Commission's approval of PBI incentive levels and annual budgets that include the cost of PBI payments constitute "de facto approval of utility PBI payments."

15. On August 7, 2009, SunRun, Inc. ("SunRun") filed comments in the docket. SunRun also filed a request to intervene in the docket. SunRun's comments included SunRun's

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belief that the Commission should consider APS' request to increase the cost recovery guarantee to $220 million for PBI incentives.

16. SunRun also recommended that the Commission reject the APS request to reclassify school projects as residential. SunRun further recommended against the transfer of residential funding to non-residential programs. SunRun pointed out that residential solar sales in the second half of the year are typically about 50 percent higher than the first half of the year.

17. On August 10, 2009, the Solar Alliance docketed a second letter with comments concerning the APS filing of supplemental comments. The primary concern of the Solar Alliance is that too much of the residential funding would be diverted to schools, which would cause a shortage of residential project funds at the end of the year.

18. The Solar Alliance recommends that, should the Commission decide to re-allocate funds, the re-allocation should be limited to $10 million. The Solar Alliance also recommends that the Renewable Energy Credits from schools not be counted toward the REST residential requirements. In addition, the Solar Alliance recommends that such a re-allocation should be done on a temporary, one-time basis without permanent reclassification of schools as residential. Finally, The Solar Alliance recommends that, to increase activity in the residential market, the Commission should increase the incentive cap for Up-front Incentives from the current 50 percent of total system cost to 60 percent of total system cost.

<u>History of Incentive Levels</u>

19. As the REST Rule development process took place in the 2004-2006 timeframe, the Arizona Solar Energy Industry Association ("AriSEIA") docketed one incentive plan that recommended incentives that would encourage distributed energy projects. A key component of that incentive proposal was that the incentive levels would drop by 10 percent each year.

20. In 2007, when APS filed its 2008 REST Plan, the incentives offered were to be constant for 2008 and 2009 and then drop by 10 percent in 2010. This approach was approved by the Commission. However, in 2008, when APS filed its 2009 REST Plan, APS decided not to propose a drop in incentives in 2010. Instead, APS proposed keeping the incentive levels constant for 2008, 2009, and 2010, followed by a 10 percent drop in 2011.

Staff Analysis

21. Staff has reviewed the APS Production Based Incentive Project Cap Analysis that is included in this document. This analysis projects a total of 48.1 MegaWatts ("MW") of new PBI projects that could receive APS commitments by the end of 2009, if the Commission approves the new $220 million recovery guarantee cap.

22. Staff analysis shows that if this 48.1 MW of new projects operate at a 20 percent capacity factor, a total of 84,271,200 kWh will be produced each year from the new projects. This number is greater than the non-residential distributed REST requirement (75,213,000 kWh) in 2010. Staff believes that the APS claim that the projects now in the queue would be enough to meet the 2009 and 2010 non-residential distributed energy requirements is correct.

23. Staff believes, based on its analysis of the APS projections, that the increase in the recovery guarantee to $220 million is justified in order for APS to meet its 2009 and 2010 non-residential distributed REST requirement.

24. Staff has reviewed APS' supplemental filing and agrees with APS that a reallocation of funding and redefinition of residential distributed energy systems to include schools will allow for more distributed energy projects to be installed in 2009 and 2010.

25. Staff has reviewed SunRun's comments. Staff points out that according to reports on the APS website, only 23 percent of the residential incentive budget for 2009 had been spent or reserved by June 30, 2009. That amount is $11,416,626 of the residential budget of $49,300,000.

26. Staff points out that, using SunRun's comments about the second half of the year being 50 percent higher than the first, the historical trend suggests that only $17-18 million in additional residential projects will be reserved in the second half of 2009. If one subtracts $18 million from the remaining $37,883,284, the amount likely to be unused at the end of 2009 is approximately $19.8 million. Even if the residential sales **doubled** in the second half (to $22,833,253), there would likely be $15 million of unused residential funding on December 31.

27. Staff has reviewed the comments of The Solar Alliance. Staff agrees that a mechanism to ensure that residential funding does not run out before year end might be comforting. There are many possible solutions to this dilemma. One solution would be for the

Commission to re-allocate $10 million to schools at the August Open Meeting. This would leave approximately $27 million for residential projects. Then on October 1, 2009, APS could be allowed to re-allocate up to 40 percent of the unreserved residential funds to schools. Finally, on December 1, 2009, APS could be allowed to re-allocate 40 percent of the still unreserved funds. However, Staff believes this is unnecessary due to the balance remaining in the residential incentive budget.

28. Staff agrees with The Solar Alliance that this re-allocation should be on a temporary, one-time basis. Any school projects funded through the re-allocation of 2009 funds would be counted toward the residential requirements for the life of each school project. This procedure would not be repeated again in the future without Commission approval.

29. Staff's analysis of The Solar Alliance's incentive cap increase shows that such an increase would have the opposite effect of what was intended. Instead of **increasing** the number of residential solar systems installed, it would actually **reduce** the number of systems installed. An illustrative example shows this unintended consequence:

> If there is $10 million available for residential projects, and the average total system cost is $10,000, the incentive with the current 50 percent cap will be $5,000 per system. However, under the Solar Alliance's proposed 60 percent cap, that same system will receive a $6,000 incentive. So, for $10 million under the 50 percent cap, APS will fund 2,000 solar systems ($10 million / $5,000 per system). However, under the proposed 60 percent cap, APS will only be able to fund 1,666 systems, a **reduction** of 334 systems.

<u>Staff Concerns and Comments</u>

30. Staff has developed concerns about the significant increased demand for non-residential photovoltaic PBI incentives. Staff believes that the recent rush to apply for incentives may be the result of four factors:

- Because of the recession, many schools and local governments are facing severe budget problems. The installation of new solar systems could save a city or school districts enough on monthly electricity to avoid the furlough or lay-off of a number of teachers or employees.

- Federal stimulus money is now available for renewable projects, but "shovel ready" projects are expected to be operational by the end of 2010.

. . .

- The incentive level for PV projects is too high, causing a rush by the PV industry to install projects while incentives remain high.
- Due to the recession, demand for PV panels is lower than anticipated in the world-wide market. This has created an excess supply of PV panels and a lower than expected demand for PV panels, thereby significantly reducing the world price for PV panels. Due to this lower panel price, solar developers see the APS PV PBI incentive of 18 – 25 cents/kWh as a profit bonanza while the incentives are still high.

31. Staff disagrees with the comments of Solar Alliance that no cap is necessary on the recovery guarantee. Just in the last eight months, since the Commission approval of the APS 2009 REST Plan in Decision No. 70654, the estimate of the recovery guarantee has grown from $77 million to over $220 million. This increase is due to the unanticipated influx of photovoltaic system PBI incentive requests. At currently proposed incentive levels and without such a cap, the recovery guarantee could easily grow to $0.5 billion 2010 and to $1 billion or more in 2011.

<u>Staff's Suggestions Related to Concerns</u>

32. Staff believes that if, in 2009 alone, APS can contract with enough projects to meet two years of REST requirements, it could well afford to lower its incentives for PV PBI projects in 2010 to levels that were originally scheduled, in the APS 2008 REST Plan, to be offered in 2010. Currently, APS plans to offer its 2008 and 2009 incentive for PV PBI systems in 2010: 25 cents per kWh for 10-year contract / 20-year PBI incentive, 20.2 cents per kWh for 10-year contracts, 18.7 cents per kWh for 15-year contracts, and 18 cents per kWh for 20-year contracts.

33. Since the vast majority of renewable projects that have been submitted to APS are for photovoltaic projects and the incentives for PV projects are significantly higher than the incentives for most other renewable technologies, the incentive levels for PV drive the recovery guarantee numbers. For instance, if the annual output for the 48.1 MW of new projects is 84,271,200 kWh as calculated by Staff, a 1.8 cent per kWh reduction in the PV PBI for 20-year contracts from 18 cents per kWh to 16.2 cents per kWh would save APS $1.5 million per year or $30.33 million over 20 years for the same number of kWh.

34. At a public meeting with the renewable industry on June 2, 2009, APS announced the overall results of its 2008 Request for Proposal ("RFP") for Distributed Energy Resources.

APS indicated that the costs per kWh resulting from the bids in the RFP were significantly lower than the proposals submitted as part of the normal non-residential reservation process.

35. Staff is concerned that the normal non-residential PBI process is offering much higher incentives for PV systems than are necessary to encourage robust participation in the REST program. If PBI incentives were lowered, for PV systems only, to the level originally planned for 2010 (in the APS 2008 REST plan), more PV projects could be funded and more renewable kWh could be produced for the same amount of money expended.

36. Staff believes that in the normal non-residential PBI reservation process, any project developer should be allowed to submit a proposal offering to accept an incentive **lower** than the incentive in the approved REST Plan. If such an offer is made, APS should consider such a project on a priority basis before others that are asking for the published incentive and, if the project meets all other APS criteria, APS should contract with the lower incentive project before considering higher incentive projects.

<u>Staff Recommendations</u>

37. Staff recommends approval of the APS request for an increase in the PBI incentive recovery guarantee to $220 million, under the following conditions:

- APS shall modify the photovoltaic non-residential (grid-tied) incentive in its proposed 2010 REST Plan to: 22.5 cents per kWh for a 10-year contract / 20-year PBI incentive, 18.2 cents per kWh for a 10-year contract, 16.8 cents per kWh for a 15-year contract, and 16.2 cents per kWh for a 20-year contract. All other REST incentives will remain the same.

- Any project developer shall be allowed, in the APS *non-residential* PBI reservation process, to offer to accept an incentive that is lower than the published incentive. If such an offer is made, APS shall consider such a project on a priority basis before others that are asking for the published incentive and, if the project meets all other APS criteria, APS shall contract with the lower incentive project before considering higher incentive projects.

- Any PV PBI proposal, received after June 30, 2009, shall only be considered for the modified 2010 PV PBI incentive, as required in these conditions.

CONCLUSIONS OF LAW

1. Arizona Public Service Company is a public service company within the meaning of Article XV, Section 2 of the Arizona Constitution.

2. The Commission has jurisdiction over Arizona Public Service Company and the subject matter of the joint application.

3. The Commission, having reviewed the application and Staff's memorandum dated August 11, 2009, concludes that it is in the public interest to approve APS' request for $220 million in cost recovery guarantees for the costs of incentive payments incurred to meet the Company's obligations for PBI incentives as discussed herein.

ORDER

IT IS THEREFORE ORDERED that Arizona Public Service Company can recover the costs of incentive payments that are incurred to meet Arizona Public Service Company's obligation for PBIs up to $220 million for all PBIs entered into through 2010 under the following conditions:

- Arizona Public Service Company shall modify the photovoltaic non-residential (grid-tied) incentive in its proposed 2010 REST Plan to: 22.5 cents per kWh for a 10-year contract / 20-year PBI incentive, 18.2 cents per kWh for a 10-year contract, 16.8 cents per kWh for a 15-year contract, and 16.2 cents per kWh for a 20-year contract. All other REST incentives will remain the same.
- Any project developer shall be allowed, in the Arizona Public Service Company non-residential PBI reservation process, to offer to accept an incentive that is lower than the published incentive. If such an offer is made, Arizona Public Service Company shall consider such a project on a priority basis before others that are asking for the published incentive and, if the project meets all other Arizona Public Service Company criteria, Arizona Public Service Company shall contract with the lower incentive project before considering higher incentive projects.
- Any PV PBI proposal, received after June 30, 2009, shall only be considered for the modified 2010 PV PBI incentive, as required in these conditions.

IT IS FURTHER ORDERED that Arizona Public Service Company shall make a compliance filing within 15 days of the effective date of this Commission Decision. This filing should include a revised incentive chart for the Arizona Public Service Company 2010 Renewable Energy Standard Implementation Plan, reflecting the conditions included herein.

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IT IS FURTHER ORDERED that Arizona Public Service Company shall file the modified incentive chart, required herein, and the wording of the conditions required herein, in the current docket for the proposed Arizona Public Service Company 2010 REST Plan.

IT IS FURTHER ORDERED that this decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______day of __________________ , 2009.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: ___________________________

DISSENT: ___________________________

SMO:RTW:lhm\CH

SERVICE LIST FOR: Arizona Public Service Company
DOCKET NO. E-01345A-09-0263

Ms. Deborah R. Scott
Arizona Public Service Company
Post Office Box 53999/ MS 9708
Phoenix, Arizona 85004

Mr. Tom Alston
Mr. Scott S. Wakefield
Ridenour, Hienton, Kelhoffer & Lewis, PLLC
201 North Central Avenue, Suite 3300
Phoenix, Arizona 85004-1052

Mr. Steven M. Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Janice M. Alward
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007