

ORIGINAL

OPEN MEETING AGENDA ITEM



0000101792

Alliance

JB

TO: Arizona Corporation Commission
FROM: The Solar Alliance
DATE: August 17, 2009

RE: IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR AUTHORIZATION FOR INCREASE IN RECOVERY GUARANTEE FOR PRODUCTION BASED INCENTIVES FOR DISTRIBUTED RENEWABLE ENERGY GENERATION. (Docket No. E-01345A-09-0263).

The Solar Alliance appreciates this opportunity to respond to Commission Staff's (Staff) proposed order regarding Arizona Public Service Company's (APS) request to allocate unused residential funds to school projects and use the associated Renewable Energy Credits to count towards compliance with the Renewable Energy Standard and Tariff (REST) residential distributed energy requirement. The Alliance continues to have three primary concerns with the proposed changes to APS's incentive program included in the Staff Report.

1. Availability of Funds for Residential Projects

The Alliance has no objection to spending unused residential funds on schools at the end of the year (after December 31, 2009), as long as this is done on a one-time basis. However, Staff's proposal to allocate \$20 million of residential funds to schools fails to take into account the effect of a potential shortage in funds on the residential market. The Alliance estimates that residential reservations will grow by 50% in the second half of 2009. The market experiences an upsurge in the second half of the year because customers typically want to realize federal and state tax credits before the calendar year is over. This trend suggests that an additional \$17-\$18 million of residential projects will be reserved in the remainder of 2009. Since there is currently \$37.8 million of residential funds remaining, this would leave approximately \$19.8 million in unused residential funds on December 31, 2009 (page 4 of Staff's Report).

By allocating \$20 million to schools, the proposal would potentially create a shortage of \$200,000. The Alliance anticipates that even the perception of a shortage would trigger a run on the residential market. The graph below is taken from SRP's Resource Planning Workshop held on August 5, 2009. It shows that when the residential incentive was reduced from \$3.00 to \$2.70 per watt, there was a surge in residential applications which grew by more than 400%.

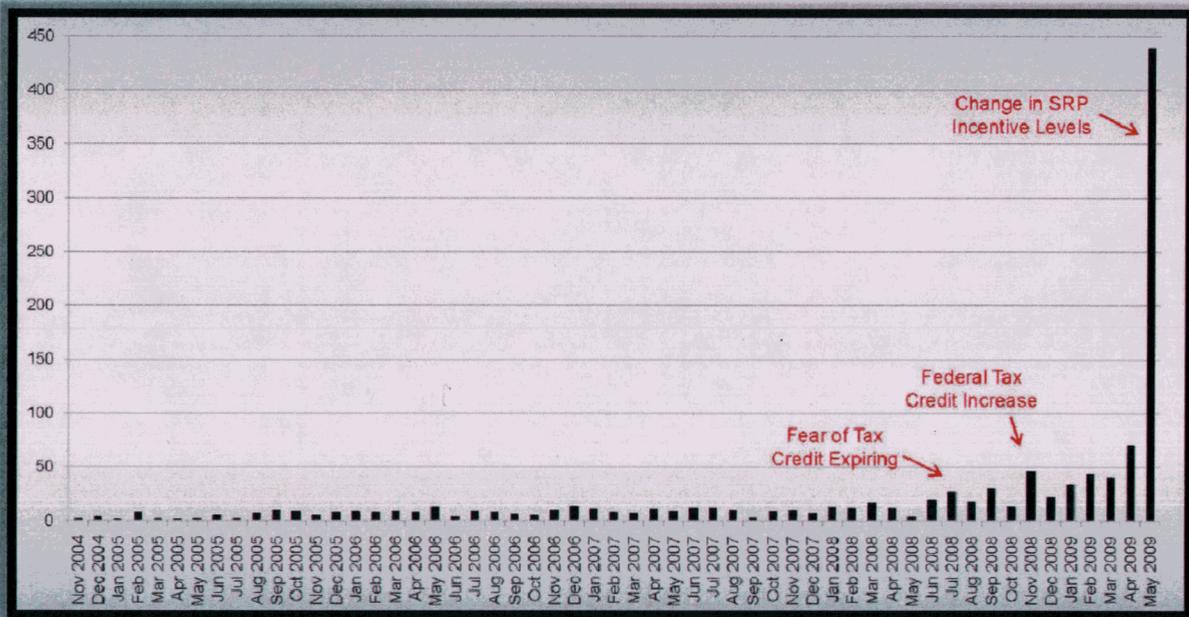
Arizona Corporation Commission
DOCKETED

AUG 20 2009

DOCKETED BY

RECEIVED
2009 AUG 20 P 4: 17
AZ CORP COMMISSION
DOCKET CONTROL

Residential Solar Applications



SRP RP Workshop 8/5/2009

R.M Hayslip



The prospect of funds running out would likely have a similar effect on APS's residential program. The success of this program hinges on predictability in the market. A shortage of funds would severely undermine public confidence in the program at a critical stage in its development. While it is unlikely, given current trends, that all of the funds in the residential program will be used by the end of the year, the Commission should ensure that enough funds remain available for residential projects through the remainder of 2009.

In its original comments on this docket, the Alliance proposed that only \$10 million be allocated for schools. Because our primary concern is that funding will be available for residential projects for the remainder of 2009, the Alliance is flexible on this number. It is even willing to support some other mechanism for ensuring that residential funding remains available.

2.0 Reclassification of Schools as Residences

The Alliance strongly opposes reclassifying RECs generated by school projects as residential. While it is certainly a policy call to reallocate funds within the program so that the maximum amount of DG projects are completed, reclassifying RECs generated by school projects would clearly contradict the intentions of the Commission's policy.

The residential DG carve-out exists for a reason: to allow residential customers to participate in the program and have some measure of control over their energy-future. These customers are paying into the program with the expectation that program goals will be met, not by changing the definition of residential, but by appropriate incentives, marketing and good policy. The Alliance believes that APS has done a commendable job implementing its residential program. The Alliance further believes that the residential market is growing at a pace that will achieve compliance in the near-term. If APS falls short of compliance in 2009, this should not be a catalyst for major program redesign. Rather, as part of its 2010 REST Implementation Plan, APS should propose a solution that would allow it to achieve residential compliance without using school RECs.

2.1 The Definition of Residential

Schools are not residences. The Alliance agrees with SunRun that because this term is undefined in the REST, it should be given its plain and ordinary meaning. There may very well be mixed-use facilities which could present a 'close call' on this issue. But schools are not one of them. It is essential that the definition of residential, whatever it is, not be determined on an ad hoc basis. SunRun cites established case law which defines residential using a simple dictionary definition. The Alliance agrees that this definition is adequate. Residential should be defined as the "circumstances or fact of having one's usual or permanent abode in or at a certain place" (SunRun's comments, page 6).

The Alliance also points out that APS frequently defines what is residential in its day-to-day operations as a Public Service Company. Certain customer classes are considered residential for billing purposes, while others are classified as commercial and industrial. To the Alliance's knowledge, APS does not typically offer a residential rate schedule to schools. Nor do the schools pay the residential environmental surcharge. In other words, APS itself does not define schools as residential. The Alliance therefore supports a policy that would *not* count RECs generated by schools on a commercial or industrial rate schedule towards the residential DG requirement.

2.2 Concerns about Precedent

The Alliance primary concern in this matter is that reclassifying school projects as residential sets a precedent, both in terms of future policy decisions and in terms of the overall residential market in Arizona.

In terms of future policy decisions, the Alliance is skeptical that the proposed reclassification would be done on a one-time basis. The Alliance does not doubt the Commission's intention in this specific instance. But if the Commission concedes that market conditions are an adequate justification for non-compliance in the residential market, the Alliance doubts that APS will have an incentive to achieve residential compliance in the future.

Over the short life of the REST, Arizona has already seen a huge influx of solar manufacturers, installers and financiers that is directly attributable to the residential DG requirement in this State's RES. In order to achieve compliance, more of these companies will need to move to Arizona. Policy consistency in the near-term is essential for long-term growth of the market.

2.3 The Use of Residential Funds

Having already stated that the Alliance does not oppose spending unused residential funds on school projects at the end of the year, it is not necessary to reclassify their RECs as residential in order for them to receive these funds. APS is understandably concerned that allocating residential funds to schools in 2009 without counting the RECs towards compliance would create a deficit in the residential program that would have to be made up in 2010. APS has already demonstrated a willingness to go beyond compliance in the non-residential sector. If schools were given the proposed UFI, this would simply bring the cost of non-residential compliance forward rather than spreading it over the 10- or 20-year lifetime contract, for example. The long-term savings in the non-residential program would have to be reallocated back to the residential program at a future date.

To the Alliance's knowledge, most school projects would receive a PBI. Therefore it is difficult to estimate the impact of this proposed change. In order for the Commission to make an informed decision, the Alliance believes that APS should provide information about how many school reservations are currently pending, how much interest it anticipates if it were to offer a UFI to schools, and how schools that currently have applications for a PBI will be treated if they expressed a preference for a UFI under this proposal.

Furthermore, the Alliance supports lifting the \$75,000 cap on incentives for schools. This appears to be necessary for these projects to be feasible. However, there has been no indication of what kind of cap will replace the \$75,000, if there will be one at all. The Alliance assumes the cap would be 50% because it is 50% for residential UFIs. This should be made more explicit.

3.0 Determination of the Optimum Incentive Level

The Alliance stresses that the matter under consideration is worthy of more detailed attention. There is clearly a tremendous disparity between the residential and non-residential parts of the DG program. Accordingly, more analysis needs to be done to determine what the optimum incentive levels are for both the residential and non-residential programs. The Alliance offers the following analysis to initiate this discussion.

3.1 Non-residential Incentives

Staff's report recommends that APS decrease its PBI by 10%. While the Alliance does not, in principle, oppose this reduction, it should be noted that the 10% number is essentially arbitrary. The table below attempts to demonstrate that a PBI which is 10% lower will have no financial impact on REST funds beyond those associated with the time value of money. This table describes a hypothetical, 1MW project with a 10-year contract/20 year PBI.

	Current Incentive for 10-year PBI	10% Reduction for 10-year PBI
PBI	\$0.25/kWh	\$0.225/kWh
System Size	1MW	1MW
Annual kWh Generated	1,750,000 kWhs	1,750,000 kWhs
Annual PBI payment	\$437,500	\$393,750
Total System Cost	\$5.5 million	\$5.5 million
Total Incentive Payment	60% = \$3.3 million	60% = \$3.3 million
Years to reach 60% cap	7.54 years	8.38 years
UFI equivalent	\$3.30/ W-STC	\$3.30/W-STC

The total cost of this project is \$5.5 million. Under the current incentive, annual PBI payments would be \$437,500 and the time it would take to reach the incentive cap would be roughly 7 ½ years. Over the lifetime of the project, APS would pay \$3.3 million (60% of \$5.5 million). If the PBI were reduced by 10%, annual PBI payments would be slightly lower—\$393,750—and it would take a little over 8 years to reach the 60% cap. In other words, under both incentive structures, the overall impact on REST funds is the same: \$3.3 million in total incentive payments. Under this scenario, reducing the incentive level has little overall impact on lifetime REST funds.

While a scheduled reduction in PBIs of 10% provides a measure of predictability to the market, the above analysis indicates that 10% may be inadequate. The Alliance believes that APS is in a better position to offer—with industry input—a recommendation for an incentive adjustment in the non-residential sector *based on market conditions*. It is therefore proposing that a formal process be initiated in order to determine the optimum incentive level for non-residential PBIs before formal action is taken on this matter, and before APS's 2010 Implementation Plan is approved.

3.2 Residential Incentives

Staff has rejected the Alliance's proposal to increase the residential incentive cap to 60% so that parity is reached with APS's non-residential program and with TEP's residential program which offers a \$3.00 per watt UFI or 60% of total system cost. The Alliance points out that, under the scenario described above, APS is currently paying its commercial customers the equivalent of \$3.30 per watt of PV capacity while it is paying its residential customers \$3.00 per watt up to 50% of the total system cost. The Alliance believes that this may account for some of the disparities in the program.

Contrary to Staff's analysis, the Alliance maintains that raising the cap on residential incentives to 60% would encourage *more* systems to be built. Staff's analysis that paying more per system would allow fewer systems to be funded is essentially correct. However, their conclusions rest on the assumption that there is only \$10 million available for residential projects when, in fact, there is a surplus of \$37 million which will likely remain unused.

Because there will be millions in surplus funds at the end of the year, the focus should be on using these funds to increase the number of systems installed rather than on maximizing the potential number of systems that can be funded. Experience within the Solar Alliance indicates that declining module prices coupled with federal tax credits has caused more projects to reach the 50% cap in 2009 than in previous years. Raising the incentive cap to 60% would cause prices to decline and encourage more residential applications and, therefore, more systems to be built. Furthermore, this is a simple solution that would not require major program redesign.

While the above analysis of APS's incentives for non-residential and residential customers is in no way exhaustive, it should serve as a starting point for further consideration about the optimum incentive level. Clearly there is a disparity in the two halves of the DG program. The Alliance contends that this should be addressed through adjustments in the program's incentives rather than through the reclassification of RECs.

Respectfully submitted on behalf of the Solar Alliance,



Tom Alston

Arizona State Lead for the Solar Alliance
tom.alston@americanpv.com