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November 9, 2009

Docket Control
Arizona Corporation Commission
1200 west Washington
Phoenix, Arizona 85007

RE: ARIZONA PUBLIC SERVICE COMPANY SUPPLEMENT TO LATE-FILED EXHIBIT 39 IN
SUPPORT OF SETTLEMENT AGREEMENT
DOCKET NO. E-01345A-08-0172

On October 2, 2009, Arizona Public Service Company ("APS") submitted its Late-Filed Exhibit 39. APS is providing supplemental information for the originally attached response to Exhibit 39 (see exhibit at 160). Attached, please find the Final Report of the Independent Auditor in APS's 2009 Request for Proposal for Renewable Energy Small Generation Resources.

If you should have any questions regarding the information contained herein, please call Susan Casady at 602-250-2709.

Sincerely,

Leland R. Snook

LS/dst

Attachments

CC: Terri Ford
Barbara Keene
Parties of Record

Arizona Corporation Commission
DOCKETED

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ARIZONA PUBLIC SERVICE COMPANY
RESPONSES TO QUESTIONS POSED AT HEARING,
REGARDING THE AMENDED APPLICATION TO APPROVE RATE SCHEDULES
DESIGNED TO DEVELOP A JUST AND REASONABLE RATE OF RETURN
E-01345A-08-0172
OCTOBER 2, 2009

Chairman Mayes:

Please provide the Commission the results of the small generation RFP and the distributed energy RFP? (1544:23-1550:25)

Response: A summary of the 2009 Distributed Energy RFP and the associated Final Independent Auditor Report prepared by Merrimack Energy Group, Inc. are attached. In addition, a summary of the results of the Small Generation RFP is also attached. The Small Generation RFP Independent Auditor Report is expected to be completed later this month.

Supplemental Response:

Attached is the recently completed Small Generation RFP Independent Auditor Report.

Arizona Public Service Company
2009 Request for Proposal (“RFP”) for Renewable
Energy Small Generation Resources

Final Report of the Independent Auditor

November, 2009

Prepared by
Merrimack Energy Group, Inc.



Final Report of the Independent Auditor – November 2009
APS 2009 Request for Proposals for Renewable Energy Small Generation
Resources

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I. Introduction

Arizona Public Service Company (“APS”) retained Merrimack Energy Group, Inc. (“Merrimack Energy”) to serve as the Independent Monitor (“IM”) for Arizona Public Service Company’s 2009 Request for Proposal (“RFP”) for Renewable Energy Small Generation Resources. Merrimack Energy’s role as Independent Monitor began during the development of the RFP and continued through the final selection of the preferred resources.

Arizona Public Service Company issued its Request for Proposal for Renewable Energy Small Generation Resources on March 25, 2009, with the objective of securing renewable energy from small generation resources. Through this RFP, APS is seeking competitive proposals for renewable energy totaling 45,000 megawatt hours (“MWh”) annually from small generation resources to meet requirements of APS’s Small Generation Pilot Program outlined in APS’s 2009 Renewable Energy Standard (“RES”) Implementation Plan. APS states that the program was created to attract small renewable projects by streamlining evaluation methodologies and contract provisions as well as considering RES eligible renewable technologies that are commercially proven but may not be as operationally mature.

The role of the Independent Monitor is defined in the April 2007 Renewable Energy Competitive Procurement Procedure (“Competitive Procurement Procedure” or “CPP”). The purpose of the Competitive Procurement Procedure is to ensure the process is implemented in a fair and unbiased manner. The CPP outlines the role of the Independent Monitor and also describes the requirements of the competitive bidding process, including the evaluation and selection process. The CPP applies only to the competitive procurement process for any solicitation initiated to meet Arizona Public Service Company’s renewable energy needs.

The Scope of Work of Merrimack Energy as the Independent Monitor was contained in the Scope of Work for the Independent Monitor (“IM”) prepared by APS as well as the Renewable Energy Competitive Procurement Procedure. The combined documents identify the following activities for the Independent Auditor:

- Review the draft RFP documents and provide feedback to ensure the documents are complete and concise and adhere to the Competitive Procurement Procedure.
- Monitor the bid evaluation and selection process, confirm that information was applied appropriately, and assure the application of the RFP process complies with the CPP.
- Attend the Bidder’s Conference (via telephone) and selected meetings between APS and bidders.

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- Review assumptions and inputs used by APS in the RFP process. APS's methodology and reasoning applied in the bid evaluation and ranking, as well as bid evaluation rationale would also be reviewed.
- Provide testimony and participate in Arizona Corporation Commission ("ACC") hearings on the RFP process to include bidder short-listing and final proposal selection (if required).
- Provide monthly RFP progress updates to ACC staff (if required).
- Inform APS of matters that could affect the integrity of the RFP process. The matter(s) must be presented to APS in a timely manner so the situation can be rectified.
- Prepare and submit a report to APS detailing the Independent Auditor's scope of review, observations and findings relating to the conduct of the Competitive Procurement Procedure and any recommendations for improvements of the solicitation process.
- Upon such a finding, the IM will prepare a certification that indicates that the procurement procedures were fair and unbiased and have been appropriately applied.
- Provide APS a final report documenting the RFP process compliance with the CPP. The report should contain any recommendations to improve the APS RFP process or CPP based on other similar industry solicitations.

This final Report meets the requirements listed above and addresses the activities associated with the solicitation process from the development of the RFP to final selection of resources in September, 2009.

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II. Requirements of the Renewable Energy Competitive Procurement Procedure (CPP)

The role of the IM in the process is to ensure the solicitation is conducted in an unbiased, equitable and transparent manner in accordance with the Certified Renewable Energy Competitive Procurement Procedure (CPP) dated April 10, 2007. The CPP applies only to the Competitive Procurement Process for any solicitation initiated to meet APS renewable energy needs. According to the CPP, each RFP will provide a description of the following:

1. Product description including timeframe for energy delivery, eligible renewable technologies, capacity and energy requirements, contract term, ownership structure options and system deliverability requirements.
2. Schedule for the process that lists the critical dates including RFP issuance date, bidders' conference, notice of intent to bid, date for submission of proposals, notification of the short list, and final selection.
3. Bid submittal instructions including the information and materials required from bidders during the process in order for the bidders to be eligible for the process. These include the Confidentiality Agreement, Proposal Certification and Summary Agreement (which includes the project description, pricing information, and bidder qualifications), and Statement of Financial Conditions and Creditworthiness Qualifications Disclosure (which includes bidders financial information, credit contacts and bank references).
4. Evaluation process and evaluation criteria. APS will use several stages in the evaluation process to review Proposals and determine the best alternatives. Price will be a major factor, with appropriate consideration given to Respondent experience and qualifications, operational performance, resource reliability, firmness, deliverability, predictability, credit, environmental impacts, contract considerations and other relevant criteria. As defined, the process will include several stages including proposal threshold requirements, screening process and detailed evaluation and selection process. Bids that pass the threshold stage will be subject to a quantitative and qualitative evaluation by APS. The analysis will include a comparison of a bidders total bid cost relative to APS's market cost of comparable conventional generation. The total bid cost will be comprised of the bid price plus costs associated with system integration, delivery of resource to load, and imputed debt. The market cost of comparable conventional generation is comprised of avoided energy and capacity costs. Bids are evaluated based on quantitative and qualitative factors. From this evaluation a short list of bidders will be developed. APS will conduct a detailed evaluation for bids selected to the short list.
5. Contracts and regulatory approval

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Resources***

In subsequent sections of this report, Merrimack Energy will describe the actual development and implementation of the competitive procurement process and assess whether APS carried out the process in conformance with the CPP.

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III. Arizona Public Service Company's Competitive Bidding Process

A. Background

The 2009 Request for Proposals for Renewable Energy Small Generation Resources ("RFP") was designed to attract small renewable developers by streamlining evaluation methodologies and contract provisions as well as considering RES eligible renewable technologies that are commercially proven but may not be operationally mature. APS hopes to retain some of the same benefits large renewable energy projects bring to the communities they serve, including educational outreach, economic development and the opportunity to foster civic engagement in energy issues, by requiring additional proposal threshold criteria.¹ APS' competitive corporate affiliates were not eligible to bid in the RFP.

APS prepared an initial draft of the RFP in early March, 2009 and sent the draft to the IM for comment. Merrimack Energy provided comments on the RFP and also asked clarifying questions about select provisions of the RFP. APS made adjustments to documents to reflect comments of the IM and also responded to the questions with an explanation of their approach for addressing the issues raised. The RFP was issued on March 25, 2008. This Chapter of the report will focus on the key characteristics and requirements of the final RFP document and will also describe the process undertaken by APS to solicit proposals, select a short list of proposals, and final selection.²

B. Summary of the Components of the RFP

The RFP clearly identified the requirements of APS regarding the types of products requested, the term of the bid, the amount of power (MWh) requested, the timing of need, schedule for the solicitation process, evaluation and selection criteria and process, price and non-price factors, and a description of the role of transmission cost and access. As background, a brief summary of the key components and requirements of the RFP are presented in Exhibit 1.

Exhibit 1: Summary of Key RFP Provisions

RFP Characteristics/Requirements	2009 Request For Proposals for Renewable Energy Small Generation Resources, March 25, 2009
Resource Requirements	Through this RFP, APS is seeking renewable energy totaling 45,000 MWhs per year from a diverse mix of RES eligible technologies. At the time of program approval, APS projected accepting 10,000 MWh of solar and the remainder from other

¹ This is the first RFP in which APS has implemented the threshold criteria used in this RFP.

² According to the Scope of Work of the IM, the IM's role will end at the time APS enters into contract discussions with the final selected bidder(s).

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	eligible technologies, but may elect to procure more or less of each depending on the quality and quantity of responses. The minimum project size was set at 1,500 MWh/year.
Objective of the RFP	In this RFP, APS is seeking competitive proposals to meet the requirements of APS's Small Generation Pilot Program outlined in APS's 2009 Renewable Energy Standard ("RES") Implementation Plan. The objective is to attract small renewable developers who may have had difficulties in competing in a traditional utility-scale RFP process.
Resource Timing	The commercial operation date of the project shall be no later than December 31, 2011. The contract term shall be a minimum of 5 years and a maximum of 30 years.
Eligibility	<p>The technology for the proposed project and key components must have a minimum of 6 months of established production data, been in operation at a scale of 100 kW or larger, and be scalable to produce energy on a commercial level as submitted in the proposal.</p> <p>The use of APS sites/facilities will not be permitted in the RFP.</p> <p>The small generation resource must deliver energy utilizing firm transmission service to the APS transmission (greater than 69 kV), sub-transmission (69 kV) or distribution system (less than 69 kV).</p> <p>APS retains all environmental attributes associated with the Respondents bid energy, including but not limited to renewable energy credits, greenhouse gas or carbon credits, and any other emission attributes.</p> <p>Respondents are required to meet at least 3 out of the 5 additional proposal criteria outlined in Attachment 1 to the RFP which include: (1) community participation partnerships; (2) school/educational partnership; (3) geographic diversity (located outside of the Phoenix metro area); (4) job creation; and (5) leverage of other funding sources.</p>
Product Requirements	<p>APS will only consider eligible RPS renewable technologies: biogas, landfill gas, biomass, geothermal, solar, wind, hybrid wind and solar, and eligible hydropower technologies.</p> <p>Distributed energy proposals will not be accepted.</p>

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	<p>Transactions that result from this RFP will be Purchase Power Agreements only.</p>
<p>Bidding Process</p>	<p>APS conducts a three-stage evaluation process comprised of the following steps: (1) Proposal threshold requirements; (2) quantitative (financial) and qualitative (non-financial) evaluation to identify the proposals that will be short-listed; and (3) final selection of proposals.</p> <p>APS reserves the right to select an offer that is not the lowest price, if APS determines that to do so would result in the greatest value to APS's retail customers.</p>
<p>Pricing Requirements</p>	<p>The proposal pricing shall be fixed or contain relatively stable provisions with a fixed escalation rate per year. APS will not accept bids with escalation rates tied to an index.</p> <p>Pricing shall contain the bidder's transmission construction and wheeling costs and all credit support required in the PPA. Post Development Security will be required in an amount equal to the first five years of average notional value of the transaction multiplied by a stress factor of 20%. The cost of the Post-development security should be included in the bid accordingly.</p> <p>All proposal terms, conditions, and pricing are binding through the final selection notification and subsequent contract negotiations, as well as Arizona Corporation Commission approval, if required.</p>
<p>Threshold Requirements</p>	<p>A Respondent's proposal shall comply with all of the following Threshold Requirements:</p> <ul style="list-style-type: none"> • The proposal is received on time • The proposal content includes an RFP submission fee of \$2,000 per bidder. • Confidentiality Agreements are executed by the Respondent and APS • A certified Proposal Certification and Summary is provided • A completed Statement of Financial Conditions and Creditworthiness Qualifications is provided • Redlined copy of the PPA is provided • Compliance documentation or information to satisfy at least 3 out of 5 of the criteria is provided. The proposal threshold criteria include:

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	<ul style="list-style-type: none"> ○ Community Participation Partnerships ○ School/Educational Partnerships ○ Geographic Diversity – defined as out of metro Phoenix Zip Codes ○ Job Creation – support the creation of at least 2 renewable energy jobs ○ Leverage Federal, State, or Local grants, contributions, or funding sources.
Screening Evaluation	<p>Proposals that meet the threshold requirements will undergo a quantitative and qualitative evaluation to identify proposals that will be short listed. Price will be the major factor.</p> <p>For the quantitative evaluation the respondents bid price or the amount APS would pay the bidder (which includes the transmission construction and wheeling costs and PPA credit support costs) + Additional Costs (costs to incorporate the resource into the APS systems such as integration costs and imputed debt) will be compared against the Market Cost of Comparable Conventional Generation (means APS' avoided capacity and energy costs that would be avoided by the proposed renewable resource taking into account hourly, seasonal and long-term supply and demand circumstances)</p> <p>The qualitative analysis is comprised of a high level risk assessment considering risk factors such as financial and counterparty credit, transmission, operations and project development risk. APS will also consider Respondents requested modifications to the PPA.</p>
Final Selection of Proposals	<p>Upon proposal short-listing, APS will conduct meetings with short-listed parties to gain a greater understanding of the Respondents Proposal.</p> <p>Any significant changes or understanding of the Respondent's Proposal, as a result of the short-listed meetings, will be resubmitted through the evaluation process.</p> <p>After the short-list meetings and any re-evaluation of Respondents Proposals are concluded, APS will select the final Proposals for contract execution and regulatory approval.</p>
Imputed Debt	The effects of imputed debt will be considered [if applicable].
Bid Fees	A non-refundable RFP submission of \$2,000 per respondent is required to qualify the proposal.

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C. Overview of the Solicitation Process

As noted, APS issued the RFP to the market on March 25, 2009. The RFP and related documents³ were posted on the Company's website established for this RFP under the heading of 2009 Renewable Small Gen. RFP.

Outreach Activities

APS issued an initial press release on February 17, 2009 and another on March 25, 2009 notifying the market of the release of the RFP and informing bidders of the availability of the RFP, the requirements solicited through the RFP, the website address for gaining access to the RFP and related documents, and a listing of names and phone numbers for key contacts at APS. The press release received wide distribution in local Arizona newspapers as well as national industry trade publications.

Bidders Conference

The Company also held a Bidder's Conference on April 16, 2009 for prospective bidders and other interested parties designed to provide an overview of the RFP and associated requirements, identify eligible technologies and requirements including the threshold criteria required of bidders, assessment of the evaluation criteria and evaluation process, interconnection options, bid submittal requirements, and bid submittal schedule. APS also provided the names and phone numbers for the Company contacts, and answered questions that prospective bidders may have on the procurement process.

Prospective bidders and interested parties had the option of either attending in person or calling into the Conference. The response to the Bidders Conference was robust with attendees both in-person and on the phone, with about 75 people participating in person and 40 participating via teleconference, including the IM, who participated via teleconference.

APS received a number of questions at the Bidders Conference and also received questions via the website for the RFP. A total of 15 questions were received and the Company posted the question and response on the website. The IM also received the Company's response to bidder's questions and provided comments to the APS project team if the IM felt that responses needed further clarification.

APS also provided an overview of the schedule for the solicitation. Bidders were requested to submit non-binding Notices of Intent to Bid on-line by April 30, 2009 and a

³ The documents contained as part of the RFP package include the RFP Schedule, RFP Document, Notice of Intent to Bid, Confidentiality Agreement, Proposal Certification Summary, Annual Estimated Delivered Energy form, Statement of Financial Conditions and Creditworthiness Qualifications, APS Distributed Energy Administrative Plan Project Incentive Matrix, Interconnection Requirements and Application, Distributed Energy Equipment Qualifications and Installation Guidance, Renewable Energy Standard and Tariff, and Bidders Conference Information.

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signed Confidentiality Agreement to APS by May 28, 2009. RFP responses were due on June 4, 2009 and the Shortlist Notification was scheduled for July 23, 2009. The Company received 70 Notices of Intent to Bid. The majority of the projects were solar technologies. Thirty-five Confidentiality Agreements were executed with prospective bidders.

Development of the Bid Evaluation Methodology

The IM and the Company held several conference calls to discuss the bid evaluation process and prepare for receipt of bids. In particular, one of the key points of discussion was the development of a methodology to screen bids under the expectation that a large number of proposals would be submitted. Merrimack Energy suggested that a real levelized cost methodology based on the bid price could be considered as an option. This type of methodology has been used by other utilities, particularly for processes where the resources are the same or similar types (i.e. solar PV options). Since many of the bids were expected to be solar projects, screening proposals based on bid price appeared to be a reasonable option.

After review of the methodology and further internal evaluation, APS proposed a modified avoided cost methodology, which was referred to as the Estimated Above Avoided Cost Percentage (ACC%), for the initial screening phase of the evaluation. APS's screening methodology was designed to pre-establish the avoided costs for comparison to the proposals received in advance of bid receipt. APS calculated avoided costs for 20, 25, and 30 year terms for photovoltaic fixed applications, photovoltaic single axis tracking system, and others based on a generic profile.⁴ A matrix of avoided costs was provided by Resource Planning at APS. For screening purposes, APS proposed to calculate the ratio of the levelized bid price for each offer relative to the applicable avoided cost by technology and contract term. Bids would then be ranked from lowest to highest in terms of the ACC% for purposes of selecting the short list based on this ratio. The average bid price was based on the sum of the on-peak energy price times the proposed on-peak energy provided by the bidder in its generation profile and the off-peak price times the off-peak energy divided by the total annual generation.

The screening methodology was applied only to photovoltaic options (or other similar proposals to the extent that there would be a large number of similar offers from different technologies). In this case, the methodology was applied only to PV bids. The process was not applied to any non-photovoltaic bids. Each of the non-photovoltaic offers was fully evaluated by Resource Planning at APS.

APS sent the proposed methodology to the IM along with examples of the application of the methodology. The IM concurred with the approach proposed by APS as being a

⁴ Avoided energy costs for the APS system was based on PROMOD IV simulations whereby the avoided energy cost was based on the difference in production costs between base case and base case with a 100 MW block purchase at zero costs.

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reasonable quantitative screening methodology and one that provided more detail and resolution than the methodology identified by the IM.

In addition to discussions on the quantitative evaluation methodology and input assumptions (market prices and natural gas price assumptions and the lock-down date of June 4, 2009), the IM and APS also discussed the detailed price evaluation methodology and the qualitative or non-price methodology to be applied to the evaluation of bids which passed the initial screen. The detailed quantitative evaluation methodology was designed to evaluate the generation profile provided by each short listed proposal. The detailed evaluation was designed to compare costs and benefits of the proposal. The cost of the proposal consisted of the bid price plus integration costs, where integration costs consisted of system integration costs plus imputed debt.⁵ In the evaluation, none of the bids were assessed system integration costs or transmission costs. The only integration cost considered in the evaluation was imputed debt. The Net Present Value (NPV) of total cost stream was calculated and levelized over 20 years (and 30 years) based on the Company's discount rate.

APS also calculated the NPV and levelized avoided energy and capacity cost associated with each proposal. For avoided energy cost, in this stage of the evaluation APS calculated the system average hourly avoided energy cost for each month and applied that cost to the energy generation profile proposed by the bidder as the basis for calculating the avoided energy cost. The avoided capacity cost was based on the real levelized capacity cost for the proxy capacity resource (GE LMS100 combustion turbine) times the amount of capacity bid times the capacity value for the type of resource proposed. The capacity value was derived from an outside consultant study which calculated a capacity contribution or capacity value for each renewable technology completed for APS.

The metric used by APS in the proposal ranking process was the levelized bid cost as a percentage of avoided cost. The ratio of the net present value of the bid cost to the net present value of avoided cost was initially calculated for each proposal. For purposes of unitizing the total net present value of the bid cost and avoided cost streams, APS discounted the output or generation stream as well (in levelized MWh). Both the bid costs and avoided costs were then calculated in dollars per MWh, the ratio of the bid cost to avoided cost determined, and the bids were then ranked accordingly.

APS project management indicated that the qualitative evaluation process was designed to rank each proposal in one of three categories: (1) high risk; (2) medium risk; and (3) low risk. The key qualitative factors would include: (1) Project viability risk (project status and developer experience); (2) Credit risk (financial statement review and post-development security); (3) technology (4) interconnection and (5) PPA risk. The qualitative evaluation would only be performed on proposals which passed the initial screen or cut-list.

⁵ Merrimack Energy assessed the methodology used by APS to calculate imputed debt and found the methodology to be reasonable and consistent with the methodologies used by other utilities.

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Receipt of Bids

Bids were received by June 4, 2009. A total of 30 different entities submitted responses which included 65 distinct proposals and 118 total offers when considering options offered. Twenty five of the thirty proposals offered solar projects. All proposals were in-state projects. The proposals offered renewable energy resources significantly above the amount of energy solicited in the RFP, illustrating the robustness of the process. In total, the proposals represented a maximum of 915,000 MWh of energy and 472 MW of nameplate capacity based on the largest size offered at a particular site, when adjusting for mutually exclusive options (i.e. different pricing options for the same proposal). The IA also prepared a detailed summary of the bids submitted and verified that all proposals were accounted for in the assessment.

Merrimack Energy also conducted a separate summary of the proposals received and was able to replicate the same number of proposals and offers submitted.

Threshold Evaluation

The first stage in the evaluation process consisted of the threshold requirements analysis as listed on page 8. In particular, bidders had to demonstrate they could meet at least three of the five threshold requirements listed in the RFP in order to be eligible for the next stage of the evaluation: (1) community participation partnerships; (2) School/educational partnerships; (3) geographic diversity (outside Phoenix metro area); (4) job creation; and (5) leverage of other funding sources (not including federal/state tax credits). These criteria were being used for the first time in this RFP.

In addition to the eligibility and threshold requirements, the RFP (as clarified in responses to bidder questions) listed other “must requirements” that bids had to meet. Twenty-three entities, 45 proposals and 93 offers were classified as conforming while 7 entities, 19 proposals and 25 offers were classified as non-conforming.

The majority of the entities, proposals and offers classified as non-conforming were due to the failure of a bidder to meet at least 3 of the 5 threshold criteria. The IM conducted its own assessment and suggested that APS conduct further review to determine whether or not a few select bids were conforming. APS conducted its review and reclassified a few of the proposals.

In addition, prior to classifying a proposal as non-conforming, APS’ Project Management contacted the IM with regard to its findings and basis for decision. APS and Merrimack Energy convened a few conference calls to discuss whether or not a proposal should be classified as non-conforming.

Merrimack Energy was in agreement with APS’ decisions regarding bidder eligibility and threshold requirements and whether a proposal was conforming or non-conforming based

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on our review of the proposal, the requirements listed in the RFP, and follow-up discussions with APS.

Communications With Bidders

As highlighted above, APS' competitive procurement process has involved a significant level of communications with prospective bidders through the development and maintenance of the RFP website, outreach activities designed to publicize the RFP, responses to questions from bidders, initiation of a bidders conference to address questions from the bidders about the procurement process and RFP requirements, and posting of the names and numbers of the key APS contracts.

Proposal Evaluation Process

As previously noted, the proposals were initially subject to a price screening process which was described briefly above. Proposals that were selected for the short list were then subject to a quantitative and qualitative analysis, with the quantitative analysis serving as the primary metric for evaluating and selecting proposals.

Price Screen - Above Avoided Cost Percentage (ACC%)

APS conducted an initial price screen for the bids received based on the relationship of the bid price to avoided cost using the Estimated Above Avoided Cost Percentage (ACC%) methodology. A levelized price for each offer was calculated and compared to the estimated avoided cost by technology and term of the contract. The bids were ranked by this ratio. PV bids with an estimated ratio of bid price to avoided cost (ACC%) of 180% and below were accepted for the cut list as well as non-PV options. A total of nine different bidders, which were comprised of 14 proposals and 26 offers met the 180% threshold. This represented a total of 186,622 MWh or 4.15 times the targeted annual requirements.⁶

Short List Selection

The bids that made the initial cut list were then subject to the detailed quantitative and qualitative evaluation. During the evaluation process, Resource Planning determined that several projects were subject to transmission constraints and therefore would have a zero percent capacity value, which significantly affected the quantitative results. The project team also conducted the qualitative evaluation based on the following criteria:

- Threshold evaluation criteria
- Project viability
- Technology risk
- Interconnection
- PPA exceptions

⁶ This assumes the largest proposal is selected in cases where a bidder offered multiple size options.

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For each criterion, each proposal was ranked as low, medium or high risk. The definitions and conditions for each ranking were pre-established by the members of the evaluation team responsible for each criterion. APS' evaluation team developed the back-up information to support its evaluation. The IM conducted conference calls with APS' Project Manager to review the results of the evaluation at this stage and the basis for short list selection.

Only a few bids were classified as "high risk" in any of the categories. As a result, the quantitative evaluation was the main factor in distinguishing projects.

The IM and the Company's Evaluation Team participated in a conference call in late July, 2009 to discuss the short list selection process. On August 10, 2009 the IM met with APS's Project Manager to review the results of the evaluation and basis for selecting the short list. During the call, APS presented the results of its assessment from a quantitative and qualitative perspective, including a recommendation for short list selection. The IM had also reviewed the bids in advance of the meeting. APS chose five bidders with a total of nine different proposals.⁷ These proposals all had an AAC% value less than 170% and were significantly less costly than the proposals not selected for the short list.

Based on review of the results, Merrimack Energy agreed with the selection of the short listed bidders. In particular, there was a clear breakpoint between the bids selected for the short list and those that were not accepted.

APS also informed the IA that the short list would be provided to Customer Management to discuss interconnections.

It was also determined that short listed bidders would be contacted to set up face-to-face meetings during the month of August with the intent of determining final selections by mid-September, 2009. APS indicated that two criteria would be considered in the selection determination:

- The proposals should be viable and reasonably priced proposals and should be consistent with the available budget for the program.
- Vendor and location diversity would also be considered.

Meetings were scheduled for August with each of the short listed bidders. APS established a consistent agenda for the bidders which included the following topics:

- Bidder company and project experience overview
- Project description as submitted in their proposal along with updates
- Technology, siting, permitting issues, interconnection and project schedule
- Community and/or Education Partnerships

⁷ One of the proposals selected contained three different size options.

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- Contract discussions
- Financing of the project

Subsequent to short list selection, several bidders made adjustments to their original proposals including revising the project size and updating the proposal with additional information since proposal submission. In addition, APS encouraged bidders to refresh their prices, firm up interconnections and provide additional information on site control.

APS held face-to-face meeting with all short listed bidders. The IM monitored the meetings via teleconference and also received copies of the presentations provided by the short listed bidders. Several of the bidders provided reduced prices, while others maintained their original pricing. In addition, APS revised its risk assessment based on updated information provided by the bidders.

Final Selection

APS made its final selection on September 25, 2009. The Company selected three proposals with proposed generation of 48,000 MWh annually once all projects are in commercial operations. The total nameplate capacity for the three projects is 20.5 MW ac. The three projects selected are the three lowest cost proposals based on the refreshed ACC% ratio. In addition, from a qualitative basis, all proposals were ranked as being a low or moderate risk in all categories. Finally, the total cost of all three proposals was lower than the total RES program budget for 2012, the first year when all proposals are fully operational.

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IV. Framework and Principles for Evaluating Arizona Public Service Company's Implementation of the Bid Evaluation and Selection Process

The 2009 Small Generation RFP process was undertaken over a nine month timeframe and represents a unique competitive solicitation process based on the nature of the products requested. Based on Merrimack Energy's experience with competitive bidding processes and observations regarding such processes, the key areas of inquiry and the underlying principles used by Merrimack Energy to evaluate the bid evaluation and selection process undertaken by the host utility include the following:

1. Were the solicitation targets, principles and objectives clearly defined and consistent with the requirements of the Renewable Energy Competitive Procurement Procedure?
2. Did the solicitation process result in competitive benefits for customers from the process?
3. Was the solicitation process designed to encourage broad participation from potential bidders?
4. Did Arizona Public Service Company implement adequate outreach initiatives to encourage a significant response from bidders?
5. Was the solicitation process consistent, fair and equitable, comprehensive and unbiased to all bidders?
6. Were the bid evaluation and selection process and criteria reasonably transparent such that bidders would have a reasonable indication as to how they would be evaluated and selected?
7. Did the evaluation methodology reasonably identify how quantitative and qualitative measures would be considered and applied?
8. Did the Request for Proposals (i.e. RFP document, the Bid Form, and Standard Contract) describe the bidding guidelines, the bidding requirements to guide bidders in preparing and submitting their proposals, and the bid evaluation and selection criteria?
9. Did the utility adequately document the results of the evaluation and selection process?
10. Did the solicitation process include thorough, consistent and accurate information on which to evaluate bids, a consistent and equitable evaluation process, documentation of decisions, and guidelines for undertaking the solicitation process?

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The implementation of the 2009 Small Generation RFP process relative to the characteristics identified previously is described below. Merrimack Energy has had no involvement in the contract preparation process and is thus not in a position to discuss this objective.

1. Solicitation Targets

The RFP document clearly defined the amount of power requested, the timing for providing the power, the type of products and product characteristics requested, the allowable contract terms, threshold requirements, bidder eligibility, schedule for undertaking the process, the evaluation and selection criteria and process, and the context of the RFP and associated documents consistent with the requirements of the Arizona Corporation Commission. APS provided the information to bidders in both the RFP document and at the Bidders Conference and clarified any issues in responses to bidder questions.

2. Competitive Benefits

The solicitation process encouraged a significant response from the market, with 118 total offers from a large number of bidders. This resulted in a response of nearly 20 times the amount of energy requested. In addition, the bidders included some of the largest and most experienced solar project developers. APS had hoped to encourage non-solar proposals from small renewable developers to diversify the mix of small-scale renewable energy resources on its system by proposing a limit on the amount of power it would take from solar projects. Unfortunately, only 8 of the 65 proposals submitted were from non-solar resources. However, the significant level of competition for solar options ensured that the best projects could be identified and selected. The process should result in competitive benefits to customers, albeit without the diversity of resource types APS was hoping to encourage.

3. Broad Participation from Potential Bidders

As noted above, the process encouraged a robust and competitive response from a range of respondents, including large, experienced, and financially sound project developers and local project development firms. The level of interest from the market as witnessed by the number of bids and participation in the bidder's conferences was substantial. In our view, the solicitation process certainly succeeded in encouraging a number of renewable project proposals, albeit the majority of which were solar projects.

4. Outreach Initiatives

APS undertook reasonable efforts to inform the market of the issuance of the RFP and the Company's requirements through targeting both national and local entities. APS issued press releases and publicized the issuance of the RFP. The Company established an easily

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accessible website which included all the information required by bidders to submit a proposal. The availability of documents, questions and answers, and notifications about the process allow bidders to maintain accessible contact. In addition, participation at the Bidder's Conferences was outstanding, indicating significant market interest and involvement.

5. The solicitation process should be consistent, fair and equitable, unbiased, and comprehensive

The principal focus of our assessment of APS's RFP process and the Company's performance in carrying out the process was on the bid evaluation and selection process. The key criteria (fair, equitable, consistent and unbiased) are applied to APS's implementation of the evaluation and selection process as well as APS's ability to adhere to the requirements outlined in the RFP documents and associated requirements of the Certified Renewable Energy Competitive Procurement Procedure. Therefore, the critique will focus on the implementation of the process rather than specific issues regarding the process.

In our view, APS's evaluation and selection process was consistent throughout and was easily reviewable and verified by the IM. Merrimack Energy's independent review of the evaluation confirms that the bids were consistently and fairly evaluated from a quantitative and qualitative perspective in both the screening and detailed evaluation stage.

In addition, the level of detail and support of the quantitative and qualitative evaluation was reasonable and consistently applied across all proposals. APS provided all the detailed back-up documentation necessary to verify the results.

The price evaluation methodologies were designed to evaluate bids using the same or consistent set of input parameters and assumptions. The methodology used by APS to compare bid prices to avoided costs is a reasonable methodology frequently used by other utilities in similar processes. In our view, the methodology was fairly and consistently applied to all bidders.

With regard to bias, the most obvious consideration is whether the process favors one type of bidder, technology or project structure over another. Since the majority of bids were for a similar type technology any presence of bias would likely be in the implementation of the process itself or project structures, rather than the criteria or other information that could affect different bidders. As noted, APS used the same methodology to evaluate all bids but was very cognizant of the non-PV bids for inclusion on the short list. However, the quantitative assessment revealed that these proposals generally were not economic. The RFP was also designed to explain in detail the evaluation process, the requirements of APS, and the information that all bidders were required to submit, leading to a consistent set of information provided by all conforming bidders.

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We do not believe any bid had an inherent competitive advantage within the parameters of the RFP. The non-compliance assessment and follow-up information requirements ensured all bidders provided the same information for evaluation purposes. Also, APS was focused on ensuring that all bidders competed on an equal footing and had access to the same information. In all cases, bids that were classified as non-conforming submitted offers that were clearly inconsistent with the requirements of the RFP.

The solicitation process was well structured to ensure that the information required in the RFP documents were linked to the evaluation criteria. APS requested a reasonable amount of information from the bidder to gain an in-depth assessment of the proposed project and utilized all the relevant information to evaluate the offer.

6. Transparency of the Process

The RFP documents and responses to questions led to a process where reasonably sophisticated bidders would be aware how to effectively compete. The threshold, quantitative and qualitative criteria were provided as well as a description of the requirements. The information required of bidders was generally clear and concise as witnessed by the complete and consistent proposals submitted by most bidders. Our only concern was the reason why so many proposals were classified as non-conforming. We are not certain if this was due to the lack of knowledge on the part of bidders, confusion with regard to the specific requirements of the RFP regarding the five criteria, or the opinion of the bidders that APS would not classify bids as non-conforming even if the bidder provided no information on specific criteria.

7. Application of Quantitative and Qualitative Measures

The RFP document articulated the quantitative and qualitative criteria and methodology and requirements associated with the evaluation process. The methodologies, cost components and models were generally described in the RFP. Although the RFP did not describe the price screening methodology that was implemented due to the prospect of a very robust response, in our view the application of this methodology was consistent with the general evaluation methodology used by APS in the detailed assessment and did not have any adverse impact on the ultimate results. Also, the pricing forms were included in the RFP document, which facilitated competition.

8. The RFP Documents should describe the process clearly and provide adequate information on which bidders could complete their proposals

This objective deals with the quality of the documents contained in the RFP (i.e. RFP documents, Proposal Certification and Summary (information requirements from bidders), Statement of Financial Conditions and Creditworthiness Qualifications, Interconnection requirements, and information on the standard program. APS's RFP provided considerable detail regarding the information required of bidders, the basis for

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evaluation and selection, and the criteria of importance. The RFP process clearly provides a direct link between the RFP document and Proposal Certification and Summary. The quality of the RFP documents and the clarity of such documents for the bidders can be observed by the quality and organization of the bids. For the most part, the proposals submitted were complete, thorough in terms of providing the information requested and well organized. We view this to largely be the result of the quality of the Bidding documents.

9. Documentation of Results

Based on our review, it is obvious that all evaluators maintained detailed information to support their evaluation of the bids from both a quantitative and qualitative perspective. In addition, Merrimack Energy was provided with detailed spreadsheets and other consistent documentation to support the evaluation of the bids.

10. The solicitation process should include thorough, consistent, and accurate information on which to evaluate bids

The bid form requires a significant amount of information that bidders must include in their proposals. Under APS's evaluation process, the vast majority of this information is used in the analysis and is consistent with the evaluation criteria developed. The level of information provided by bidders ensured that APS could undertake a consistent and comprehensive analysis of each proposal and reflect the individual attributes of each proposal in the evaluation. We found no biases in the evaluation criteria or process and found the documentation to be very thorough.

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V. Conclusions and Recommendations

A. Conclusions

The RFP procedures followed by APS and the subsequent bid evaluation and selection processes and methodologies are, in substance, consistent with industry standards and represent a fair, consistent, and unbiased evaluation and selection process. The information included in the RFP, the evaluation process and evaluation criteria, and requirements are also consistent with the Renewable Energy Competitive Procurement Procedure (“CPP”). The following summarize some of the major considerations relative to the consistency of the RFP for Tenders with industry standards.

In the opinion of Merrimack Energy, the bid evaluation and selection process was undertaken by APS in a fair, consistent and comprehensive manner. In addition, in our view, this process was a very thorough, rigorous, and comprehensive evaluation and selection process, with every eligible bid scrutinized in detail. Both the quantitative and qualitative assessments were effectively undertaken, which should result in competitive prices and viable projects. The implementation of the solicitation process was effectively managed by APS, was conducted in conformance to the schedule outlined in the RFP, and should lead to benefits to consumers.

The bid evaluation and selection process was undertaken in a consistent and comprehensive manner with all bids treated fairly and equitably. A list of important aspects of the bid evaluation and selection process is provided below.

1. The solicitation process was a very competitive process, with nearly 20 times the amount of energy bid than the amount required. The significant response to the RFP led to a competitive process, with over 100 offers received from 30 bidders.
2. This is the second APS RFP in which Merrimack Energy was the IM. In both cases we found the process to be well structured and managed within a consistent framework whereby all bidders have adequate information to base a well designed proposal.
3. The RFP documents were detailed and transparent documents that clearly identified the unique nature of the solicitation process, the products requested, the information required of the bidders’ and the bid evaluation and selection process.
4. The outreach process was broad reaching and targeted to potential bidders. The activities were designed to attract a wide audience of bidders. The outreach activities in question include marketing of the RFP, access to the website for bidders, response to questions, and the Bidders Conference.

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5. APS responded to a number of questions from bidders and posted the responses on its RFP website. In our view, APS staff was very responsive to the needs of bidders and such communication with bidders led to comprehensive and responsive proposals.
6. APS addressed all of Merrimack Energy's questions and issues in a reasonable and satisfactory manner. There were no outstanding issues that affected the integrity of the solicitation process.
7. The evaluation process followed by APS (i.e. Threshold Requirements, Price Screening Process, and Detailed Evaluation on the short listed bids) outlined in the RFP is, in substance, consistent with the approaches followed by other utilities. In particular, the use of quantitative analysis as a primary criterion for selection of the preferred proposals is common practice in the industry.
8. The initial price screening methodology was a sound methodology for screening large numbers of proposals and is consistent with APS' traditional evaluation methodology.
9. The quantitative analysis undertaken in both the Price Screening Process and Detailed Evaluation stage to compare the bid price to APS's avoided costs is similar to methodologies used by other utilities for competitive solicitation processes for renewable resources. While some utilities may compare the bid price to the value of the power supplied to the market as an alternative, a number of utilities also apply an avoided cost methodology as a substitute. In our view, such an approach is appropriate and consistent for such processes.
10. The quantitative evaluation methodology was effective in comparing bids with different commercial operation dates, generation levels, project structures and degradation rates. This methodology proved effective in evaluating and ranking the different proposals and variants.
11. All proposals that passed the threshold requirements stage and initial price screen were thoroughly and consistently evaluated and ranked based on a detailed quantitative and qualitative assessment. All evaluation results were thoroughly scrutinized by APS's bid evaluation team and Merrimack Energy. Merrimack Energy reviewed the avoided cost calculations completed by APS in detail.
12. Merrimack Energy was in agreement with APS's selection of both the short listed bids and the final bids for negotiation. With regard to the short list, there was a clear distinction between lower cost and higher cost bids. Furthermore, with few exceptions, the short listed bids also performed reasonably well in the qualitative evaluation.

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13. The qualitative criteria used were generally consistent with those criteria used by other utilities for renewable resource solicitations. While some utilities apply broader criteria and apply weights in combination with quantitative factors to determine a short list, the approach used by APS is reasonable and consistent with industry standards. Furthermore, the RFP and related materials clearly identified the key parameters and criteria that will be applied in selecting short list and final bids.
14. The face-to-face meetings with short listed bidders was a very valuable component of the process and served as an opportunity to assess the status of a bidders' proposal and gain a better perspective of the experience and capabilities of prospective bidders.

In conclusion, it is our view that the solicitation process and assessment undertaken by APS was fair, consistent, comprehensive and unbiased. APS established procedures and rules which guided the evaluation and selection process, and consistently applied such procedures. The evaluation and selection process effectively conforms to the requirements of the RFP, reflects the practices of other similar utilities in conducting such a process, and represents good utility practice.

B. Recommendations

As previously noted, the goals of the program to attract small renewable projects that may have had difficulties in competing in traditional RFP processes is laudable. While Merrimack Energy found overall that the RFP process was well conceived and managed and produced very competitive resource options, we have a few recommendations for future solicitations of a similar nature relative to the goals of the program.

1. The fact that so many proposals were deemed non-conforming was surprising given that bidders had to meet only three out of five criteria. We would suggest in future RFPs should APS prefer to use the same threshold criteria that APS provide more guidance to bidders on how they can meet the threshold requirements and/or revise the threshold criteria. This could include providing more information to bidders during the bidder's conference, requesting that bidders complete the threshold criteria matrix with how they intend to respond or reassessing the actual criteria to ensure bidders could reasonably conform. For example, the last criteria, Leverage Federal, State, or Local grants, contributions or funding sources, may not be relevant or applicable for some bids. Instead of requiring a letter of support or commitment from a funding source, perhaps it may be preferable to require bidders to demonstrate they have made every attempt to secure federal, state, or local funding sources.
2. APS had hoped to encourage more proposals from small renewable developers and non-PV resources. However, even though the RFP clearly

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stated this preference, such proposals were lacking. This could have been attributed to the small size requirements for non-PV resources, the timeframe required for getting the project on-line or the expectation that PV projects would be the most competitive at the size limits established. Some utilities conduct targeted solicitations designed to encourage different types of resources or technologies. Perhaps APS could conduct small scale renewable resources RFPs targeted to specific technologies such as biomass or wind. This may provide a greater incentive for such resources to compete. However, with such processes it may be important to set a cap on the price APS is willing to pay if the number of bids is limited and competition is weak.