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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman

GARY PIERCE
Commissioner

PAUL NEWMAN
Commissioner

SANDRA D. KENNEDY
Commissioner

BOB STUMP
Commissioner

Arizona Corporation Commission

DOCKETED

MAR 17 2010

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IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S APPLICATION
FOR APPROVAL OF ITS AZ SUN
PROGRAM

DOCKET NO. E-01345A-09-0338

DECISION NO. 71502

ORDER

Open Meeting
March 2 and 3, 2010
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

I. Background

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

2. On July 1, 2009, APS filed its application for approval of its 2010 Implementation Plan ("Plan") pursuant to the Renewable Energy Standard and Tariff ("REST") Rules. A Supplement to the Plan filed by the Company on October 16, 2009 included the proposed AZ Sun Program ("Program"), a large investment in APS-owned photovoltaic ("PV") solar generating facilities.

3. Although the Commission approved the 2010 Implementation Plan with modification, the Commission's Order provided the following with respect to the Program: "Staff has recommended that a decision on the AZ Sun Program be deferred to no later than the February

1 2010 Open Meeting in order to more thoroughly analyze the issues related to this Program.” Staff
2 recommends approval of the AZ Sun Program subject to conditions discussed herein.

3 **II. The AZ Sun Program**

4 4. AZ Sun is a new part of APS’ overall renewable strategy that the Company states
5 will focus on accelerating the development and commercial operation of solar generation resources
6 through utility ownership. Today APS’ renewable portfolio consists primarily of Power Purchase
7 Agreements (“PPAs”) for renewable resources. The Company states that this is partially a
8 function of the fact that utilities were prohibited from taking the Investment Tax Credit on
9 renewable generation investments. The federal tax laws enacted on October 3, 2008 (as part of the
10 Emergency Economic Stabilization Act of 2008) removed this prohibition.

11 5. APS points out that utility-owned solar projects offer several benefits:

- 12 ▪ Economies of scale and associated volume discounts.
- 13 ▪ Placement of resources where they will benefit the distribution system the most.
- 14 ▪ Investment tax credits and accelerated tax depreciation that can reduce revenue
15 requirements.
- 16 ▪ Easier financing supported by the Company’s balance sheet.
- 17 ▪ No imputed debt related to PPAs.
- 18 ▪ Increased certainty that projects will go forward.

19
20 6. APS states that solar PV is now more suitable for ownership because the systems
21 can be installed quickly as compared to other types of generation resources. Further, the various
22 solar PV technologies themselves are more mature, and costs have come down making solar
23 systems more economically attractive.

24 7. APS also states that these systems are the most versatile of the utility-scale
25 generation technologies as they can be designed to consider various shapes and sizes of available
26 land, can be located in the Company’s distribution system where feeders are close to capacity or
27 where transmission congestion may be an issue, and can also be scaled to meet the resource needs
28 of the area in which they are situated.

1 8. APS anticipates the facilities would be ground-mounted solar PV systems. APS
2 states that ground mounted PV systems can be properly aligned with the available sunlight in order
3 to maximize system production. According to APS, the program may also include utility scale
4 systems located on customer premises, thereby qualifying as distributed energy.

5 9. In response to a Staff Data Request, the Company states that it views "utility-scale"
6 generating resources to be those with an energy output designed to broadly serve the Company's
7 customer load. "Utility-scale" resources are not necessarily defined to be a specific size, but rather
8 can be developed at any appropriate size, given a range of resource planning and site specific
9 needs and characteristics. "Utility scale" according to the Company, defines a purpose, rather than
10 a size. As part of the implementation of the AZ Sun Program, APS states that it anticipates utility-
11 scale photovoltaic installations ranging in size from 10 MW to 25 MW.

12 10. As proposed, APS plans to develop 25 MW a year in each of 2011, 2012, 2013 and
13 2014. The Company may accelerate development of this capacity if it is reasonable to do so.

14 11. Overall, the AZ Sun program entails a capital investment of approximately \$500
15 million to be made in years 2010 through 2014 to develop the 100 MW of solar generation
16 capacity. This is based on an average solar PV capital cost of \$5.00 per watt and would require an
17 investment of \$125 million for each 25 MW increment of solar resources. The cost of the actual
18 systems deployed will be based on competitive procurement processes, and will likely vary with
19 the size of system facilities. Smaller systems tend to be a greater per-unit cost, while larger sized
20 systems cost less due to economies of scale. APS expects to acquire the resources through a
21 competitive procurement processes beginning in 2010.

22 12. APS states that approval of this Program will allow the Company to install these
23 resources quickly and efficiently without additional regulatory filings.

24 13. The Company's 2011 Implementation Plan will contain the details of the AZ Sun
25 Program capital investments for at least the first year of the program.

26 **III. Cost Recovery**

27 14. APS is proposing that revenue requirements for the AZ Sun Program including
28 income taxes, depreciation, property taxes, and O&M expenses and financing costs using the then-

1 currently authorized cost of capital, would be recovered through the RES adjustor until the
2 investment is included in base rates or another recovery mechanism.

3 15. The revenue requirement that APS calculates for each annual \$125 million
4 investment is estimated to be \$16.1 million in the first year of operation, declining each year over
5 the life of the facilities, like a typical utility investment. APS states that the revenue requirement
6 for each 25 MW increment declines each year to \$5.2 million in the final year of its life and totals
7 \$256 million over the 30-year life of the facilities. The annual amounts would be recovered
8 through the RES surcharge until the investment is included in base rates or another recovery
9 mechanism. APS further states that full development of the 100 MW through the AZ Sun Program
10 will require cumulative revenue requirements over 30 years of approximately \$1.024 billion. This
11 amount would be the sum of the revenue requirements for the four 25 MW increments that have a
12 cumulative revenue requirement of \$256 million each.

13 16. Staff Data Request 1.1 asked the Company its position on the appropriateness of
14 establishing an above market cost for utility-owned projects such as the Program, which is similar
15 to the methodology used for PPAs. APS replied that for a PPA, "market" costs are recovered
16 through a combination of the base fuel rate and the Power Supply Adjustor ("PSA"), while above
17 market costs are recovered through the RES adjustor. The combination of the three mechanisms
18 results in full recovery of the PPA cost for APS.

19 17. For an APS-owned project such as the Program, APS states that it would finance
20 the cost of the asset through a combination of debt and equity and incur ownership costs such as
21 property taxes, depreciation and operation and maintenance expenses. The costs cannot be
22 recovered in base rates until APS' next general rate case unless the PSA mechanism is modified to
23 recover more than fuel and purchased power costs. APS states the easiest and most appropriate
24 way of recovering the revenue requirement costs of the AZ Sun Program between general rate
25 cases is through the RES adjustor mechanism. APS believes that allowing for full recovery of
26 costs between rate cases through the RES adjustor will put utility ownership on the same footing as
27 PPAs, which was the intent of Section 15.7 of the Settlement Agreement ("SA") approved in
28 ...

1 Decision No. 71488. APS further states that without this timely recovery of costs, APS likely
2 could not finance its ownership of renewable generation projects.

3 18. In Decision No. 71488, the Commission approved the SA between the parties in the
4 Company's last rate case. Section XV of the SA involved additional commitments by the
5 Company to invest in renewable energy projects. APS witness Lockwood testified that the new
6 renewable resources required by the SA are in addition to existing resources or commitments as of
7 the end of 2008 as identified in APS' 2008 annual RES Compliance Report.

8 19. Subsection 15.7 of the SA provides in part as follows:

9 All reasonable and prudent expenses incurred by APS pursuant to this
10 Section of the Agreement shall be recoverable through the Power Supply
11 Adjustor, a renewable energy adjustment mechanism, or the Transmission
12 Cost Adjustor, as appropriate. To encourage least cost renewable resources
13 to benefit customers, these expenses would also include the capital carrying
costs of any capital investments by APS in renewable energy projects
(depreciation expenses at rates established by the Commission, property
taxes, and return on both debt and equity at the pre-tax weighted average cost
of capital).

14 20. Staff believes that the Company's proposals are consistent with the SA, subject to
15 the understanding that the reasonableness and prudence of such costs shall be determined at the
16 Company's next rate case, and that the Company shall be required to refund any amounts that are
17 determined to be unreasonable or not prudent.

18 21. APS notes that resources under this program are not likely to commence
19 commercial operation until 2011. As such, the requested 2010 RES adjustor does not include any
20 amounts for the AZ Sun Program revenue requirements.

21 22. APS states that it will include an updated budget for this Program in its 2011
22 Implementation Plan as specific resources are identified.

23 23. APS states that explicit support for the investment and assurance of cost recovery in
24 this docket, however, will provide the commitment necessary for APS to attract viable projects and
25 successfully arrange the financing necessary for this Program to be successful.

26 **IV. Renewable Energy Standard Rules**

27 24. APS has indicated that some Program facilities may be located on non-residential
28 customer premises, thereby qualifying as a Distributed Energy ("DE") project.

1 25. The Commission, however, recently ruled, in Decision No. 71459 which stated "IT
2 IS FURTHER ORDERED that Arizona Public Service Company shall be, consistent with the
3 Renewable Energy Standard rules, prohibited from utilizing utility-owned facilities for purposes of
4 meeting the non-residential portion of its distributed generation requirement."

5 26. Staff has recommended that the Commission find that the renewable energy
6 produced by utility-owned Program facilities not count toward compliance with the non-residential
7 portion of the distributed renewable energy requirements of the RES Rules.

8 27. In response to a Staff Data Request, APS states that it plans to install only utility-
9 scale photovoltaic generating resources as part of the Program. It is Staff's understanding that
10 APS does not propose to develop any facilities for purposes of meeting the residential portion of
11 its distributed energy requirement through the Program.

12 **V. Staff Recommendations**

13 28. Staff has recommended that APS' AZ Sun Program be approved by the
14 Commission as discussed herein.

15 29. Staff has recommended that the Commission find that the allocation of RES
16 funding for the return, income taxes, depreciation, property taxes, and O&M expenses of the AZ
17 Sun Program, until the Company's next rate case, as proposed by APS is appropriate and
18 reasonable.

19 30. Staff has recommended that the reasonableness and prudence of those costs be
20 examined during the Company's next rate case and that any costs determined not to be reasonable
21 and prudent be refunded by the Company.

22 31. Staff has recommended that the Commission find that the renewable energy
23 produced by utility-owned Program facilities does not count toward compliance with the non-
24 residential portion of the distributed renewable energy requirements of the RES Rules.

25 32. While the Commission believes that utility ownership of renewable energy projects
26 can be beneficial to both the Company and its customers, we are also mindful of the benefits that
27 accrue from renewable energy produced by independent power providers. As The Vote Solar
28 Initiative noted in its comments filed in this docket, independently produced and locally sited solar

1 generation has the potential to ease transmission bottlenecks on a utility's system, thereby
2 lowering costs for ratepayers associated with incremental new generation and distribution
3 infrastructure. Providing an opportunity for independent power providers to assist utilities in
4 meeting the RES also brings an element of competition to the RES programs and could leverage
5 private capital in a way that lowers the cost of renewable energy over time. It is today unclear
6 whether utility-owned solar will ultimately prove less expensive than solar produced by
7 independent power providers, and by pairing utility-owned solar projects with projects provided by
8 developers, the Commission will be able to compare the costs of these projects on a levelized cost
9 of energy basis.

10 33. Therefore, we believe that APS should be required to develop a plan for
11 Commission consideration to procure at least 25 megawatts of solar from independent power
12 providers, in addition to the 100 megawatts that are being approved in this Order. Additionally,
13 we believe that because the 25 megawatts would be procured generation, the costs associated with
14 the 25 megawatts would be eligible for recovery through the Company's Power Supply
15 Adjustment mechanism. The Company should make a proposal for the 25 megawatts using the
16 Company's Small Generation Pilot Program. We will require APS to make such proposals as part
17 of its 2011 REST Implementation Plan.

18 **VI. Discussion**

19 34. The Commission believes that it is appropriate, at this time, to approve the
20 Company's proposed cost recovery as recommended by Staff for only the first 50 megawatts of
21 utility-scale solar at issue in this application. The specifics of the cost recovery mechanisms
22 associated with the remaining 50 megawatts should be addressed in the Company's next rate case.
23 Specifically, we believe that in the Company's next rate case, a mechanism should be considered
24 that would allow APS to recover the costs, consistent with Section 15.7 of the Settlement
25 Agreement, associated with the remaining 50 megawatts. Examples of possible mechanisms may
26 include:

- 27 • Revisions to APS' Power Supply Adjustor ("PSA") to allow the costs to be flowed
28 through the PSA, or

- 1 • An adjustment mechanism that would allow APS to include the plant costs associated
2 with these 50 megawatts in rate base following Staff filing of a memorandum in the
3 rate case docket verifying that the plant has been placed into service. The Company's
4 base rates would then be increased accordingly to allow the recovery of the costs
5 associated with this plant. The rate increase would be effective for service rendered
6 beginning the first day of the month following the filing of Staff's verification
7 memorandum.

CONCLUSIONS OF LAW

8 1. APS an Arizona public service corporation within the meaning of Article XV,
9 Section 2 of the Arizona Constitution.

10 2. The Commission has jurisdiction over APS and over the subject matter of the
11 application.

12 3. The Commission, having reviewed the application and Staff's Memorandum dated
13 February 10, 2010, concludes that it is in the public interest to approve the AZ Sun Program, as
14 discussed herein.

ORDER

15 IT IS THEREFORE ORDERED that Arizona Public Service Company's AZ Sun Program
16 be and hereby is approved as recommended by Staff, except as modified as discussed in Section
17 VI of this Order and delineated in the following ordering paragraph.

18 IT IS FURTHER ORDERED that in Arizona Public Service Company's next rate case, the
19 Commission shall determine the cost recovery mechanism, consistent with Section 15.7 of the
20 Settlement Agreement, for the second 50 megawatts of the AZ Sun Program that may include the
21 following examples:

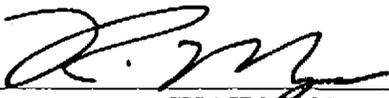
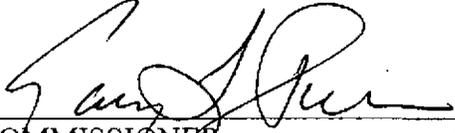
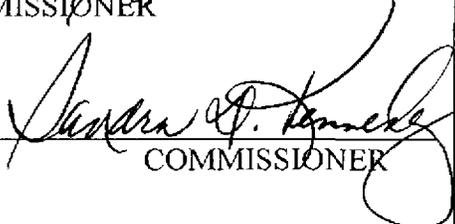
- 22 • A modification to Arizona Public Service Company's Power Supply Adjustor that
23 would allow the costs to be flowed through the Power Supply Adjustor, or
- 24 • Establishment of a mechanism that would allow Arizona Public Service Company to
25 include the plant costs associated with these 50 megawatts in rate base following Staff's
26 filing of a memorandum in the rate case docket verifying that the plant has been placed
27 into service. Arizona Public Service Company's base rates would then be increased
28 accordingly to allow the recovery of the costs associated with this plan. The rate
29 increase would be effective for service rendered beginning the first day of the month
30 following the filing of Staff's verification memorandum.

1 IT IS FURTHER ORDER that Arizona Public Service Company shall develop proposals to
 2 procure at least 25 megawatts of solar (these 25 megawatts are above and beyond the 100
 3 megawatts in the Company's proposed AZ Sun Program) from independent power providers and
 4 file the proposals as part of the Company's 2011 REST Implementation Plan, and possibly using
 5 Arizona Public Service Company's Small Generation Pilot Program.

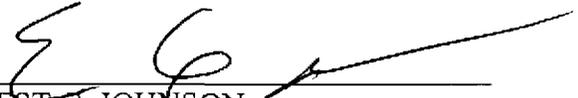
6 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

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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 17th day of March, 2010.



 ERNEST G. JOHNSON
 EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

SMO:JJP:lhm/WVC

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