Antonio Gill OPEN MEETING AGENDA ITEM E-20690A-09-0346

ORIGINAL

From: John LeSueur on behalf of Pierce-Web
Sent: Thursday, June 24, 2010 6:41 PM
To: Antonio Gill
Subject: FW: IREC letter on SolarCity Proceeding
Attachments: IREC Letter on SolarCity ROO.pdf; ATT2236915.txt

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-----Original Message-----
From: Sky Stanfield [mailto:sstanfield@keyesandfox.com]
Sent: Thursday, June 24, 2010 1:02 PM
To: Newman-Web; Pierce-Web; Mayes-WebEmail; Kennedy-Web; Stump-Web
Cc: Kevin Fox, Esq.
Subject: IREC letter on SolarCity Proceeding

Dear Commissioners,

Good afternoon. Attached to this email is a copy of a letter the Interstate Renewable Energy Council (IREC) has submitted to the docket office providing comments on the Recommended Opinion and Order issued in the SolarCity matter (Docket No. E-20690A-09-0346). Thank you very much for your consideration.

Sky Stanfield (on behalf of Kevin Fox)

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KEYES&FOX LLP
DISTRIBUTED GENERATION LAW
436 14th Street, Suite 1305
Oakland, CA 94612
(510) 314-8200

June 23, 2010

Chairman Mayes
Commissioners Pierce, Stump, Kennedy and Newman
Arizona Corporation Commission
1200 W. Washington St., 2nd Floor
Phoenix, AZ 85007

Dear Commissioners,

The Interstate Renewable Energy Council ("IREC")[1] respectfully submits this letter to express its concerns regarding the Recommended Opinion and Order ("ROO") on whether the provision of various services pursuant to Solar Service Agreements ("SSAs") makes Solar City a "public service corporation" under Arizona law. (ACC Docket No. E-20690A-09-0346).[2] For the reasons discussed in this letter, IREC strongly encourages the Commissioners to reconsider the ROO and instead adopt the Findings of Fact and Conclusions of Law articulated in Commissioner Mayes' proposed amendments. IREC also supports the amendments of Commissioner Pierce, but would like to propose one important change, which is discussed in Section III of this letter.

Summary

The ROO does not provide a compelling case for the need to regulate Solar City at this time, nor does it address how any such need would outweigh the considerable adverse impact that regulation would have on the development of the solar market in Arizona. It would be counter to both the law of Arizona and common sense for the Commission to regulate Solar City without first finding that such regulation is in the public interest. By comparison, the amendments proposed by Commissioners Pierce and Mayes appropriately focus on whether regulation serves the public interest.

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[1] IREC is a non-profit organization that has worked for nearly three decades to accelerate the sustainable utilization of renewable energy resources through the development of programs and policies that reduce barriers to renewable energy deployment. IREC addresses topics that directly impact the development of renewable energy resources, including regulations that affect the ability of solar clients to finance their projects.

[2] The undersigned was admitted to practice *pro hac vice* on IREC's behalf in a related proceeding on Feb. 27, 2009 (ACC Docket E-20633A-08-0513).

The ROO and Staff concede that the need for rate control is not a principal concern at this time and that there is not a fear of monopoly power with which to contend. The ROO's conclusion that the power provided through SSAs is indispensible ignores the fact that customers will be connected to the grid and will maintain access to electricity through that means. To regulate a free and competitive market without evidence of monopoly power or the provision of an indispensible service is likely to harm the public interest more than help it. Commissioner Mayes and Pierce appropriately consider the public interest and recognize that regulation of this competitive industry is not warranted at this time.

I. Consideration of the Public Interest is Essential to Determining whether Solar City is a Public Service Corporation

As briefed extensively in the Exceptions filed by the parties in this case, an entity is not automatically a public service corporation in Arizona simply because it meets the extremely broad textual definition set out in the Arizona Constitution. The Arizona Supreme Court long ago observed that the constitutional definition is overlybroad, if examined and applied in isolation. For example, a literal extension of the ROO's conception of "furnishing" could very easily reach net-metered customers, even if they own their own panels. Any individual who, through net-metering, sells power back to the utility at the end of the year when customers are paid at an avoided cost rate for excess generation, could also be considered to be "furnishing power" to the public. It would clearly be an over-extension of the constitutional definition to conclude that every net-metered individual is a public service corporation, or to conclude that regulation is appropriate at that scale.

It is the excessive breadth of the "furnishing" definition that the Arizona courts have attempted to curb by requiring the application of the *Serv-yu* factors. As the Commissioners' amendments recognize, along with furnishing power, the activities of such an entity must also "be such as to make its rates, charges and methods of operation, a matter of public concern, clothed with a public interest to the extent contemplated by law which subjects it to governmental control – its business must be of such a nature that competition might lead to abuse detrimental to the public interest." *Southwest Transmission Cooperative, Inc. v. ACC*, ("*SWTC*"), 213 Ariz. 427, 431-32, (Ariz. Ct App. 2007) (*quoting Trico Elec. Coop, Inc. v Ariz. Corp Comm'n*, ("*Trico*") 86 Ariz.29, 34-35, (1959). The ROO's determination that the public interest analysis of the *Serv-yu* factors is unnecessary could potentially require the Commission to regulate any entity that furnishes power, no matter how small, insignificant, or trivial and without respect to whether there is any public interest in regulating such an entity. IREC encourages the Commission to think carefully before approving such reasoning.

The essential need for regulation of public service corporations comes from the fact that they provide an indispensible public service and that they exercise monopoly control that could result in unfair or discriminatory pricing that could preclude access to those essential services. *See* Alfred E. Kahn, *The Economics of Regulation: Principles*

and Institutions 1-19 (1988). The ROO concedes that SolarCity is not a monopoly, and that the need to regulate rates such as you would with a monopoly does not exist here. ROO at 47. However, the ROO finds that as soon as SolarCity's PV facility is "installed on school property, the electricity the schools receive from SolarCity will displace electricity from the incumbent utility and thus will be equally 'essential.'" ROO at 43. Under such reasoning, even private individuals who own PV panels would be providing an indispensible service. Likewise, those who install a more efficient refrigerator, and thereby "displace" electricity, would be providing an indispensible service. The amendments proposed by Chairman Mayes and Commissioner Pierce appropriately recognize that the financing of distributed solar is not an essential public service. Although the provision of non-utility solar could conceivably at some point become a substantial enough proportion of the state's market to warrant regulatory oversight, to regulate now is ambitious at best and could have an ironic effect of never allowing such a result to materialize due to the "chilling" effect of regulation.[3] For these reasons, the Commission must establish that regulation is in the public interest before proceeding to regulate.

II. Regulation May Actually Harm the Public Interest

IREC believes that regulation at this time is actually counter to the public interest and runs the substantial risk of undermining the efforts that the State of Arizona has been taking to create a vibrant market for solar technologies in the state.

As explained in detail in the briefs filed by SolarCity, SunPower, and others, and as recognized by the Mayes and Pierce proposed amendments, the central purpose of SSAs is to provide a funding mechanism for entities[4] that would otherwise be unable to raise the upfront costs necessary to invest in PV systems or who cannot take advantage of federal tax credits that are crucial to cutting up-front investment costs by as much as half. However, in order for SSAs to be attractive to tax equity investors, investors demand a reasonable level of certainty on income stream. There is a limited amount of money available for these types of tax equity investments and there are other types of projects that are in competition with SSAs for those dollars. The threat of rate regulation and the concern that regulation will delay project approval undermines the certainty about the security of this investment and will make SSA-funded PV projects less attractive to tax equity investors. It is important to note that Arizona competes with all the other states in the nation for these limited funds. If the Commission decides to regulate SSAs, it will be the only state in the nation to do so, thus making SSA projects in Arizona immediately less competitive.

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[3] The ROO never makes clear why it would be in the public interest to regulate SSAs over any of the other types of financing arrangements currently used in the solar market. The fact that SSAs require the sale of power, but make few other meaningful distinctions from lease or direct ownership, does not make a compelling case for regulation in the public interest.

[4] School districts, non-profits, and government agencies are all heavily reliant on SSAs and PPAs because they cannot use federal tax credits. However, private individuals and companies also rely on SSAs and PPAs when their taxable income requires such a financing mechanism.

One of the key factors that distinguishes SSAs with schools, nonprofits and governmental entities from traditional utility agreements with such entities is that each contract is individually and freely negotiated by sophisticated parties, usually following a competitive RFP process.[5] The United States Supreme Court has expressly recognized the importance of not disturbing freely negotiated power contracts, noting the chilling effect that uncertainties regarding rate stability and contract sanctity can have on investment in the energy sector. *NRG Power Marketing v. Maine Public Utilities Commission*, 130 S.Ct. 693 (2010) (*citing* Market-Based Rates ¶6, 72 Fed. Reg. 39906 (2007)). In the context of wholesale power agreements, the *Mobile-Sierra* Doctrine was created to expressly protect freely negotiated contracts from regulatory disturbance, because, as the Court noted, "competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are extraordinary circumstances." *NRG* at 700 (*citing Nevada Power Co. v. Duke Energy Trading & Marketing, L.L.C.*, 99 FERC ¶61,047, pp. 61,184, 61,190 (2002). While this doctrine applies in the context of FERC regulation of wholesale energy markets, the same is true here where the threat of regulation will undermine investment, particularly where there is not evidence of a compelling need for regulation.

The state has expressed its desire for increased renewable energy and the REST goals demand that by 2012 30% of the overall target be met through distributed generation. While solar is becoming more and more cost-competitive, it still involves a large up-front investment that few entities are capable of funding on their own. Due to this, in 2008, PPAs were used to fund roughly 90% of the non-residential solar market in the United States, and non-residential projects are an ever-growing proportion of the overall installed capacity in the nation. Mark Bolinger, *Financing Non-Residential Photovoltaic Projects: Options and Implications*, Lawrence Berkeley National Laboratory, Jan. 2009, LBNL-1410E, 18; Larry Sherwood, *Solar Market Trends Report 2008*, IREC, 4 (2009). Hindering the availability of PPAs or SSAs as funding mechanisms could be a critical blow to the market for non-residential solar in Arizona and will make it considerably more difficult for the state to meet its REST targets. Opposition to regulation of SSAs is not driven by a fear of "inconveniencing" the industry as Staff has suggested (see ROO at 54, n. 180), it is driven by the real risk that regulation will inhibit growth of clean energy in Arizona, harming not only the industry, but job growth in the state, consumers and the environment.

IREC fears that investors will just skip over projects in Arizona altogether if SSAs and PPAs are regulated, but even a simple delay in investment until regulations are adopted is likely to be detrimental to Arizona's effort to meet the REST standards, create green jobs and to increase use of cleaner forms of power. Investors are likely to at least take pause and wait to see how regulations play out before making substantial investments. Any delay is meaningful and could cause Arizona to lose ground in the market and fall behind in meeting the REST targets. In this economy, where job growth

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[5] Commissioner Pierce's amendments also point out that these contracts require individualized pricing which is another factor that distinguishes them from traditional utility agreements.

is happening very slowly, making a decision to slow or halt an area with substantial employment potential is a move that Arizona cannot afford. The Commission has made excellent progress in establishing net metering, interconnection and associated policy decisions that support the growth of distributed solar in Arizona, but without meaningful financing mechanisms available this work will be wasted.

To remedy this situation, the Commission should adopt the amendments proposed by Chairman Mayes, which direct the Commission towards a path more beneficial for the growth of Arizona's solar energy market and for its citizens.

III. Regulation of SSAs would be Complex and Resource Intensive for the Commission and Regulated Entities

In light of the potential scope of regulatory jurisdiction that the reasoning in the ROO leads to, regulation of SSAs is likely to be extremely cumbersome for the Commission. While the case before the Commission only involves SolarCity's unique financing mechanism, the scope of reasoning applied in the ROO could sweep in SSAs and PPAs of other sorts without any reasonable justification, and without the Commission first satisfying due process and substantial evidence prerequisites to such an assertion of regulatory jurisdiction. For these additional reasons, IREC supports the amendments to the ROO proposed by Commissioner Mayes.

IREC also supports the Findings of Fact and Conclusions of Law found in Commissioner Pierce's amendments, but we do believe that the paragraph proposed to be added on page 7, line 7 of Commissioner Pierce's amendments is incorrect and should not be added. Contrary to that particular proposed amendment, there has been no agreement among the parties that SolarCity would be acting as a public service corporation if it used a PPA instead of an SSA. The Commission does not have a PPA before it in this case. However, we believe that there is no meaningful difference between a PPA and an SSA in the application of the *Serv-yu* factors. Thus, IREC believes that a party entering into a PPA is not a public service corporation. Indeed, as Commissioner Pierce states elsewhere on page 7 of his amendments, it would "strain credulity" to conclude that two identical projects, just with different financing arrangements, deserve different treatment by the Commission.

Regulating SSAs or PPAs could be complex and burdensome for the Commission and its Staff, because many such agreements involve the creation of individual legal entities for each separate PV installation. Thus, unlike traditional utility regulation of monopolies, the regulation of SSAs and PPAs could mean regulating hundreds if not thousands of different entities, all of whom have individually negotiated contracts with their customers.

All of the states that have examined the question of whether to regulate third party owners of solar assets have decided not to regulate. In many cases, these decisions were first reached by a relevant public utility commission and thereafter affirmed by a legislature. For example, the Nevada PUC found that third party owned systems were not

public utilities, considering in part the intent of the state's net metering rules and overall state policy, but also noting that regulating third party owned systems "would inhibit rather than encourage the grown of private business and the use of renewable energy systems, and inhibit rather than promote the growth of the state's economy." Nevada PUC Docket 07-06024 & 07-06027, Order at 5-7. While each state has unique statutory language to interpret, there is a consensus that regulating SSAs does not serve the goals of advancement of renewable energy and that it is not necessary to protect the public interest.

In order to regulate, the Commission must undertake a necessarily time consuming rulemaking process. The Staff argues that all that it is seeking at this time is a "regulation light" approach. However, the streamlined approach proposed by Staff is ambiguous and there is no way for investors to have confidence that this is all that would come out of such regulation. Further, the *Phelps Dodge* decision appears to require rate regulation if the Commission finds that SSAs are public service corporations, even though all parties concede there is no need for such regulation here. *Phelps Dodge Corp. v. Arizona Electric Power Co-op Inc.*, 207 Ariz. 95 (2004). If the "registration" process envisioned by Staff requires individual approval of each application, this introduces a high level of uncertainty, not to mention the amount of time it would take for the Commission's Staff to complete a review of the number of applications necessary to meet the REST goals. To avoid this potential quagmire, IREC encourages the Commission to find no regulation is necessary under the *Serv-yu* factors. Staff's concerns can be appropriately addressed through other mechanisms, as noted below.

IV. The ACC Already has Sufficient Control over SSA Providers Through Existing Mechanisms to Address Staff's Concerns

IREC has carefully evaluated the reasons that Staff has provided for "needing" to regulate and believes that any legitimate concerns can be addressed through existing mechanisms. There are also a number of concerns raised by Staff that could be raised about any provision of service in the economy and thus do not seem to constitute legitimate reasons to regulate absent the presence of monopoly power and/or the provision of essential services.

The concerns about adequate and reliable service can be addressed through the Commission's interconnection standards and through net metering rules as recognized by Commissioners Mayes and Pierce. There are additional benefits to this approach in that it provides the Commission with uniform authority over all solar installations, regardless of whether they are third-party or individually owned and operated. This approach has been taken in California, Nevada and other states.

Regulating SSAs also is not going to address Staff's concerns about the need for the incumbent utilities to provide back-up power and associated forecasting and planning activities. SSAs will only be used to finance a portion of total solar installations. Regulating them is not going to provide the long-range forecasting information needed by utilities, nor is it going to provide a sufficiently wide picture of the non-utility solar

resources deployed in the state. The best avenue for this information is through interconnection rules, which will apply to all projects for which there is a need for a utility to provide back-up service.

The safety of PV systems is already adequately addressed through numerous national, state and local standards.

Staff also expresses a concern that there is nothing in place to ensure that the provision of SSA service is adequate and reliable. IREC agrees that adequate and reliable service is essential but believes that there are already sufficient protective measures in place at this time. First, since SSAs are individually negotiated in a competitive market, a customer has the ability to negotiate sufficient protections for failure in service and reliability. Like with other services, parties to an SSA have access to the court system, the Registrar of Contractors and the Attorney General's office to resolve their disputes. As addressed above, since an incumbent utility provides back-up service, this should be a sufficient remedy. In addition, it is worth noting that there has not been any evidence presented that companies providing SSAs have any history of inadequate or unreliable service, nor is there any reason to suspect that they are more likely to do so than any other business in Arizona.

Conclusion

Arizona has a wealth of solar resources and the state has been developing strong policies to promote solar market growth in recent years. A decision to regulate Solar City and its SSAs would be a significant step backwards and one that is not in the best interests of ratepayers of Arizona, the solar industry or the environment. IREC strongly encourages the Commissioners to reconsider the ROO and issue a decision that protects the public interest by allowing these crucial financing mechanisms to proceed without the burden of unnecessary regulation.

Sincerely,

Kevin Fox
Keyes & Fox LLP

Sky Stanfield on
Behalf of Kevin Fox