



MEMORANDUM

CORPORATION COMMISSION
Kristin Mayes, Commissioner



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ORIGINAL

TO: Gary Pierce; Sandra Kennedy; Paul Newman; Bob Stump

FROM: Kris Mayes

DATE: July 1, 2010

RE: Draft proposed Feed-in Tariff Policy Statement
Docket No. E-00000J-09-0505

CC: Ernest Johnson; Steve Olea, Janice Alward; Lyn Farmer; Rebecca Wilder

Dear Colleagues:

Attached you will find a draft proposed Commission Policy Statement on Feed-in Tariffs which has been prepared by my office pursuant to the comments and workshops in our Feed-in Tariff docket, Docket No. E-00000J-09-0505.

Please docket any suggested edits or modifications to the Policy Statement by Close of Business, Friday, July 9, if possible. Once changes are incorporated, I will place the item on an upcoming Staff meeting agenda for discussion and a possible vote.

Thanks for your consideration, and for all your work in this docket.

Kris Mayes

Arizona Corporation Commission
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ARIZONA CORPORATION COMMISSION
POLICY STATEMENT ON FEED-IN TARIFFS

Docket No. E-00000J-09-0505

July 1, 2010

The Arizona Corporation Commission ("Commission") has established a number of successful policies in furtherance of renewable energy in Arizona. The Renewable Energy Standard ("RES") calls for each regulated electric utility to meet 15 percent of its retail energy sales from renewable sources by 2025. Within the RES is a requirement that utilities procure 30 percent of their renewable energy from distributed sources such as rooftop solar or backyard wind energy, and electric utilities have developed, under the Commission's supervision and guidance, extremely robust distributed generation programs for residential and commercial consumers of renewable energy. Additionally, the Commission has adopted a net metering requirement and interconnection policies for electric utilities that are widely considered to be among the best in the nation. Finally, in order to meet the non-distributed portion of the RES, utilities have signed contracts to procure power from several large, centralized renewable energy projects.

In order to continue examining value-additive renewable energy policies, on January 6, 2010, the Commission issued a Notice of Inquiry ("NOI") regarding a potential Arizona Feed-in Tariff for renewable energy production in Docket No. E-00000J-09-0505. Parties supplied comments in response to the NOI, and on April 14 and 15, 2010, the Commission hosted a workshop attended by Commissioners and multiple interested individuals designed to elicit further discussion regarding the appropriateness and potential design of a feed-in tariff for Arizona's regulated electric utilities.¹

Purpose

The Commission endorses a feed-in tariff as an effective tool for utilities and the Commission to use to spur the development of additional wholesale distributed renewable energy resources. In particular, the Commission believes that a feed-in tariff, which provides greater certainty of revenue to renewable energy developers, would be a strong incentive to the development of distributed wholesale renewable energy power projects in the 0 to 20 Megawatt ("MW") range. While distributed generation projects on the customer-side of the meter have expanded rapidly under the RES, the Commission notes that to date, no utility scale projects have been built by the regulated utilities, due in part to financing difficulties experienced after the 2008 financial crisis, and no wholesale distributed renewable energy projects in the 0 to 20

¹ We take note of the fact that feed-in-tariffs are under examination or have been adopted in multiple states and municipalities. At the time of the issuance of this Policy Statement, five states had adopted feed-in-tariffs: California, Hawaii, Vermont, Maine and Oregon. Additionally, five cities or utilities had implemented a feed-in-tariff, including Gainesville, Florida, Madison, Wisconsin, Sacramento, California, San Antonio Texas and Consumer's Energy in Michigan.

megawatt range have come to fruition, despite evidence of the existence in Arizona of a significant potential pipeline of projects in this range.

We believe that a feed-in tariff would accomplish the objective of assisting the utilities in meeting their RES requirements in a less lumpy, more incremental way, which is salient given the design of the RES. Under the RES, utilities must step up their renewable energy purchases in gradual increments each year, meaning their purchases of renewable energy should conform as practicable to those increments. A feed-in tariff would allow the utilities to make purchases in proportion to their RES schedules, maximizing the likelihood that they will meet their annual and overall RES requirements in a timely. A feed-in tariff would at the same time help to smooth out the stop and start nature of an emerging industry like solar energy, making it more likely that a mature, robust market of renewable energy generators will be available to sell cost-effective energy to Arizona utilities.

Additionally, we are hopeful that a feed-in tariff will allow Arizona utilities to bring a significant amount of renewable energy generation online in a relatively short time frame, thus allowing the state to meet short term growth in electric demand with clean and reliable sources of energy. Despite the economic downturn, Arizona continues to be among the only states in the nation still experiencing growth in its population and energy demand, and implementing a feed-in tariff, along with the resulting renewable energy projects, will help the Commission analyze the potentially salutary impacts of using renewable energy to meet a growing state's energy requirements, in particular the possibility that utilities will be able to defer or delay costly new infrastructure additions by deploying renewable resources such as solar. Similarly, wholesale distributed renewable energy projects promoted by a feed-in tariff are unlikely to require the kind of expensive transmission additions and upgrades often necessitated by utility scale energy generation projects of all types, whether renewable or fossil-driven.

Indeed, we are particularly interested in the ability of a feed in tariff to avoid some transmission expenditures. While Arizona has been a leader in building transmission for years, and is engaged in a robust process for planning renewable energy transmission projects under the Biennial Transmission Assessment, the time and expense associated with constructing new transmission can often stand in the way of bringing renewable energy projects on-line in an expeditious manner. We thus find that a feed-in tariff could assist utilities and the Commission in achieving construction of renewable energy projects as they concomitantly work to bring larger projects and their associated transmission lines into their energy portfolios.

We are also persuaded that a feed-in tariff will help drive out what have been referred to in this docket as "parasitic transactional costs" associated with the Request For Proposal ("RFP") processes that are often utilized by the utilities when making renewable energy purchases. While we believe there are clear benefits associated with the RFP process, which mandates that projects compete with one another for a spot in the utilities' energy portfolios, and can result in the lowest cost project "winning", we are concerned that it may have the unintended side effect of imposing some unnecessary transactional costs on project developers, which could increase the ultimate price paid by consumers for the renewable energy produced. The RFP process may also be leading to some projects winning with bids that contain such unrealistically low prices that they are simply not capable of being financed and constructed. Adding a feed-in tariff to the mix of tools available to utilities for the selection of renewable energy projects would increase the overall number of projects constructed under the RES, and will provide the Commission much

needed visibility into which method of selection – the RFP or the feed-in-tariff - really is obtaining the best price for consumers.

Jurisdiction

The Commission is mindful of the Federal Energy Regulatory Commission's ("FERC") primary jurisdiction over wholesale sales of electricity. Pursuant to the Federal Power Act, all wholesale sales in interstate commerce, including sales made entirely intrastate, fall under FERC jurisdiction; however, the Public Utility Regulatory Policies Act of 1978 (PURPA) accords the ACC some authority to set wholesale rates. Under PURPA, states have the opportunity to establish an avoided cost price which utilities must offer to qualified facilities (QF). Under FERC precedent, states are able to provide supplemental compensation above the avoided cost payment such as through assignment of "renewable energy credits."

We believe that a properly designed feed-in tariff would avert any potential questions of jurisdiction conflict between the ACC and FERC. FERC has made it clear, in Order No. 732, that facilities under one Megawatt are exempt from certification requirements otherwise applicable to small power production or cogeneration facilities seeking qualified facility status. Accordingly, a feed-in tariff providing both REC and avoided cost compensation and comprised entirely of such projects would not run afoul of FERC jurisdiction.

Additionally, neither the FPA nor PURPA pre-empt states from establishing resource-specific procurement targets. We believe that a feed-in tariff in which routine competitive auctions are held for multiple MW projects, utilizing an established revenue requirement for each auction period and pre-negotiated standardized contracts, would not be considered FERC jurisdictional.

Design

We believe generally that the appropriate target market for what we will term the "true" feed-in tariff is between 0 and 1 MW. However, we would also like to see the utilities develop a regularized competitive auction with standardized pre-negotiated contracts, for projects between 1 to 5 Megawatts and 5 to 20 Megawatts, in order to capture cost savings associated with potential economies of scale. Smaller systems (0 to 1 MW) are currently more financeable than larger projects, more likely to be deployed by houses of worship, non-profits, Home Owners' Association ("HOA's"), governmental entities, farmers, ranchers and other rural landowners. As a result, targeting the true feed-in-tariff to these entities would be more likely to result in "steel in the ground" in the short term. Multiple megawatt systems (1 to 20 MWs) could achieve cost savings, and would allow opportunities for partnerships between large landowners in rural areas of Arizona, who are ideally suited to be the hosts of large solar projects, and the utilities.

Participants in this docket provided a wide range of views on the appropriate price for a feed-in tariff. However, we will decline in this Policy Statement to establish a price, and will rather request that the utilities propose, in consultation with all interested Parties, an appropriate price for the feed-in tariff when making their feed-in-tariff proposals to the Commission. We believe that the feed-in-tariff prices proposed to the Commission for its consideration should be differentiated based on technology type and size.

In order to avoid over-subscription of the feed-in tariff, the Commission believes that utilities, in designing their proposals for a true feed-in tariff program, should include a cap on the overall size of the program, and, in the case of projects of larger sizes utilizing a competitive auction, should establish a cap through the introduction of a set annual revenue requirement for the program. By setting an overall program cap for the 0 to 1 MW feed-in tariff, and a revenue requirement for the mid-sized feed-in tariff through auction, the Commission and utilities would have surety that the programs would never exceed allowable and prudent limits.

We believe that both the true feed-in tariff and competitive auction-based feed-in tariff should be technologically agnostic – that is any renewable energy technology that would qualify for funding under the RES should also qualify for funding under a feed-in tariff. The Commission believes that one of the most valuable aspects of the RES is that it allows a wide array of technologies to compete for a birth in the state's energy supply mix, and we would like to extend that ethic to any feed-in tariff programs developed by the utilities. Additionally, any new technologies that are permitted in the future to count toward RES compliance should also be eligible under the utilities' feed-in tariffs.

True feed-in tariffs submitted to the Commission should be proposed as a first-come, first served program. The competitive auction-based feed-in-tariff should be allocated based on a pre-determined revenue requirement, up to that requirement. Additionally, utilities should develop competitive auction-based feed-in tariffs that include relatively short timelines, modest bidder qualifications and development security requirements, in an effort to ensure project viability.

A feed-in tariff is essentially designed to fund wholesale power contracts under which the owner of a solar system provides power to the utility in front of the meter over a defined period of time, usually 20 years. Thus, we are of the view that power purchased through a feed-in tariff should be eligible for cost recovery through the utilities' respective Purchased Power and Supply adjustor mechanisms ("PSA"). We believe that at a minimum during each utility's next rate case, the utility should seek to reform their respective PSA's to explicitly allow for cost recovery of wholesale distributed renewable energy, including energy procured through both forms of feed-in tariffs discussed in this Policy Statement. Until such time as the adjustor mechanisms are reformed, we will consider requests by the utilities to pass feed-in tariff costs through the utilities' REST adjustor mechanisms, or to defer those costs for recovery in future rate cases, through a deferral mechanism. If the utilities believe they already possess the authority to pass feed-in tariff related costs through their PSA mechanism, pursuant to the existing terms of their PSA, we will consider more immediate requests pass these costs through the mechanisms as part of our review of the utility's feed-in tariff proposal.

Because the feed-in tariff is a means by which utilities would purchase power from renewable energy project owners in front of the meter – just as they would do if the generator being interconnected was for a large wind or central-scale solar plant – we believe that the proper location for RECs to be counted for compliance purposes is the utility scale portion of the utilities' RES compliance requirements.

We are also of the view that the most optimum vehicle for the implementation of a feed-in tariff at this time is in the utilities' yearly REST Implementation Plans, beginning with their 2011 REST Implementation Plans. We therefore believe it is in the public interest for the

utilities we regulate to propose, as part of their 2011 Implementation Plans, a feed-in tariff program that comports with this Policy Statement.

A feed-in tariff would be particularly helpful in facilitating renewable energy projects at houses of worship, HOA's, and non-profits, which are ineligible to secure tax credits for renewable energy projects and which would be better able to afford the development costs of renewable energy projects were they provided a dependable per kilowatt hour payment stream at a premium above the avoided cost of energy. We would like to see the utilities propose feed-in tariffs that are helpful in advancing this market segment. However, the Commission would also like to see feed-in tariffs that target cost savings that can be achieved when renewable energy systems are developed in areas where the utilities believe interconnection costs will be lowest. Therefore, we are interested in feed-in tariff proposals that would target entities that are under-represented in existing RES programs, such as HOA's, non-profits, schools and houses of worship, and proposals that would screen for high value projects from an interconnection cost savings standpoint, and where practicable, we would like to see both objectives accomplished.

Conclusion

In light of the need to advance renewable energy development in Arizona and diversify electric utilities' energy portfolios, we endorse the development of feed-in tariffs by ACC regulated utilities, as discussed above. Endorsement of a feed-in tariff will help to guide the utilities as they design feed-in tariffs, bolster Arizona's chances of developing appropriate and cost effective renewable energy infrastructure, and send an unmistakable signal to utilities, potential renewable energy developers, and financial markets that Arizona possesses a long-term commitment to renewable energy.

Kris Mayes
Chairman

Gary Pierce
Commissioner

Sandra D. Kennedy
Commissioner

Paul Newman
Commissioner

Bob Stump
Commissioner