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AZ CORP COMMISSION
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July 9, 2010

Commissioner Kristin K. Mayes, Chairman
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

JUL -9 2010

RE: Commission Draft Policy Statement on Feed-in Tariffs
Docket No. E-00000J-09-0505

DOCKETED BY

Dear Chairman Mayes:

Arizona Public Service (APS or Company) appreciates the opportunity to provide comments on the Arizona Corporation Commission's (Commission) Draft Proposed Policy Statement regarding Feed-in Tariffs (Draft Policy Statement) filed in Docket No. E-00000J-09-0505. APS has been an active participant in feed-in tariff (FIT) discussions, including the series of Commission-hosted FIT workshops held on April 14 and 15, 2010. Additionally, APS conducted a stakeholder workshop on June 9, 2010 in support of the Company's 2011 Renewable Energy Standard (RES) Implementation Plan. During that workshop, the concept of FITs and other mechanisms to deploy small renewable generation facilities was discussed with developer, installer, and advocacy representatives of the Arizona renewable energy industry. These discussions were important in shaping two key programs included in the Company's 2011 RES Implementation Plan filed on July 1, 2010 with the Commission.¹ These programs are briefly described below as background to APS's subsequent comments on the Draft Policy Statement, which follow beginning on page 2.

Proposed FIT-Related Programs Included in the APS 2011 RES Implementation Plan

Small Generator Standard Offer

This program is intended to initiate development of renewable generation projects ranging from 2 MW to 15 MW. The Small Generator Standard Offer is designed to achieve approximately 200,000 MWh annually at full deployment. The program is based on an annual budget of \$10 million above the cost of comparable conventional generation. The Company believes the competitive pricing design will result in the greatest amount of renewable energy development for the ratepayer at the least cost. Additionally, through the approval of APS's 2011 RES Implementation Plan, the program budget will allow for an expedited transaction and financing process.

¹ Docket No. E-01345A-10-0262.

Kristin K. Mayes, Chairman

July 9, 2010

Page 2

Eligible renewable facilities and their applicable criteria are described in the APS 2010 solicitation for Small Generation, and are similar to those included in the 2009 Small Generation Pilot. APS will seek to identify projects that, to the extent possible, balance low project costs with high value propositions (e.g., projects that may involve high value partnerships or facilitate local job creation). Based on lessons learned from the Company's 2009 Small Generation Pilot, APS has refined its procurement process and has created a standard contract. Improvements and efficiencies to the interconnection process will serve to further improve the timeframe from development to in-service.

APS expects a majority of the responses to this solicitation to come from photovoltaic (PV) facilities, but the Company may choose to allocate a portion of the overall budget to non-solar technologies and/or emerging, commercially-viable technology innovations depending on the substance of the proposals.

Powerful Communities - Wholesale Distributed Energy Feed-In Tariff

APS has proposed a wholesale distributed energy (DE) FIT program named "Powerful Communities." APS's Powerful Communities program targets market segments that currently have a more difficult time accessing incentive funding through the current APS portfolio of RES programs; specifically low-income housing, homeowner associations, multi-tenant facilities (residential and commercial), and not-for-profit charitable organizations. Resources eligible through this program are limited to renewable energy generation facilities between 30 kW and 200 kW, and the facility must be operational within 12 months of acceptance into the program. APS believes projects resulting from this program meet the definition of wholesale DE resources described in the RES rules.²

As proposed, the Powerful Communities program would accept eligible projects annually on a first-come, first-serve basis during the three-year deployment period of 2011 to 2013. Participation would be limited to 2 MW of eligible projects in each year of the program, for a cumulative program resource capacity total of 6 MW. Each project would qualify for only one DE incentive program. The Company has proposed a standard fixed price offer for the Powerful Communities program of \$0.195 per kWh for the output of the system under a 20-year standardized agreement. The estimated annual cost above the cost of comparable conventional generation of the program is \$375,000 and the lifetime RES commitment is approximately \$22.5 million.

APS Comments on the Commission's Draft Policy Statement

Properly designed and administered FIT programs can be useful tools in advancing the development of renewable energy projects in Arizona. The following comments are provided against the background of the two programs described above and respond to several points in the Draft Policy Statement.

² A.A.C. R14-2-1805(E).

Meeting the RES Requirements with a Market-Driven Procurement Strategy

- *“...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...”* Page 1, Paragraph 3
- *“...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...”* Page 2, Paragraph 1
- *“However, [the Commission] 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.”* Page 3, Paragraph 4

As described in the Renewable Energy Standard and Tariff Rules,³ APS is required to file an annual plan (“Implementation Plan”) describing how the Company intends to comply with the rule requirements and describing the renewable energy resources that may be added during the next five years. Based on the type of resource added, the Company adequately plans its procurement process allowing sufficient time to achieve its RES targets through the five-year period, and beyond, in accordance with the timeline presented in the Implementation Plan. Since the inception of the RES in 2007, APS has met or exceeded the annual RES requirements, in part by adding over 200 MW of renewable generation.

During 2009 and the first half of 2010, APS issued multiple competitive solicitations seeking to procure a wide range of renewable generation resources. APS’s 2009 Small Generation Pilot Request for Proposals sought various renewable generation resources ranging between 2 MW – 20 MW. The robust response to this solicitation confirmed the strong interest of renewable resource developers in this market segment, and in particular, demonstrated that pricing for PV projects had become a competitive and viable resource option. Through that pilot APS contracted with three entities for a total of 20 MW of PV resources, some of which are expected to break ground as early as the fourth quarter of 2010.

APS recognized this market trend and adjusted its renewable procurement strategy over the past nine months to extend the Small Generation Pilot program an additional three years. Further, the Company received Commission approval for the AZ Sun program which is designed to add 100 MW of PV resources in smaller increments.⁴ The April 2010 solicitation for small generation served as the first in a series over the next three years that define the Company’s Small Generator Standard Offer program. The Small Generator Standard Offer program builds on knowledge gained from the 2009 Small Generation Pilot that competitive pricing design will result in the greatest amount of renewable energy development for the ratepayer at the least cost.

³ A.A.C. R14-2-1805, et. seq.

⁴ See Decision No. 71502 (March 17, 2010).

APS believes that its Small Generator Standard Offer program supports the Commission's purpose of a FIT, for this market segment, as described in the Commission's Draft Policy Statement.

Wholesale Distributed Renewable Energy

- *"[The Commission believes] generally that the appropriate target market for what [the Commission] will term the "true" feed-in tariff is between 0 and 1 MW..." Page 3, Paragraph 1*
- *"...[the Commission believes] that the proper location for RECs to be counted for compliance purposes is the utility scale portion of the utilities' RES compliance requirements..." Page 4, Paragraph 5*
- *"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. [The Commission] 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, [the Commission is] 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, [the Commission] would like to see both objectives accomplished." Page 5, Paragraph 1*

APS's Powerful Communities Program is designed to be an additional mechanism to support the Company in achieving its RES DE goals. The Company believes that energy resulting from this proposed program is appropriately applied within the Company's non-residential distributed energy allocation as wholesale DE.⁵

APS considered multiple factors in developing the Powerful Communities program. First, the Company selected a targeted market segment under-represented in current incentive programs (low-income housing authorities, homeowner associations, multi-tenant facilities (residential and commercial), and not-for-profit charitable organizations). Second, APS determined the size range for this targeted segment that would receive the most benefit from a FIT program. APS determined that the most appropriate project size for the market segments targeted through the

⁵ A.A.C. R14-2-1801(E).

Powerful Communities program is 30kW – 200 kW, which is consistent with the medium non-residential production-based incentive (PBI) market segment. Also, by capping the upper level system size at 200kW, the renewable facilities can be developed for this market segment at more locations and without the potential for a small number of larger facilities (those approaching and including 1 MW) consuming the bulk of the program budget. The 30kW-200kW range is appropriate to meet the ultimate goal of the program, which is to encourage the development of multiple wholesale DE renewable resources for a variety of market participants.

The Company further believes that its Powerful Communities program supports the Commission's purpose of a wholesale DE FIT, as described in the Commission's Draft Policy Statement. APS believes projects resulting from this program meet the definition of wholesale DE resources described in the RES Rules⁶ and that projects resulting from this program meet the Company's annual DE requirements.

Eligible Renewable Energy Resources

- “[The Commission believes] that both the true feed-in tariff and competitive auction-based feed-in tariff should be technologically agnostic...” Page 4, Paragraph 2

The Small Generation Standard Offer program should be technologically agnostic and all Eligible Renewable Energy Resources⁷ should be afforded opportunities to participate in this program. In contrast, APS does not believe that all Distributed Renewable Energy Resources⁸ are eligible to participate in the Company's proposed Powerful Communities program. Specifically, the definition of Distributed Renewable Energy Resources includes a number of non-electric generating resources such as solar water heating, daylighting, solar pool heating, etc. For the reasons set forth below, any FIT program should include only those technologies identified under the definition of Eligible Renewable Energy Resources, excluding those that do not produce electricity.

When installed at a customer site and used to reduce a customer's electric energy consumption, non-electric generating technologies avoid electric consumption from “conventional generation.”⁹ In fact, through APS's DE incentive programs, the Company provides financial incentives toward the installation of non-electric generating distributed energy technologies in exchange for Renewable Energy Credits (RECs). Through the Company's PBI program customers are paid incentives for non-electric generating technologies based on a calculated conversion to kWh equivalents.¹⁰ However, under a wholesale transaction, as is the case in a FIT, the Company receives both the energy and the RECs. It is not clear to APS how a non-electric generating resource would transact on such energy, how that energy could be resold, and

⁶ A.A.C. R14-2-1801(R).

⁷ A.A.C. R14-2-1802(A).

⁸ A.A.C. R14-2-1802(B).

⁹ A.A.C. R14-2-1802(A).

¹⁰ A.A.C. R14-2-1803(B).

ultimately whether that energy is used to displace electric consumption from “conventional generation” and therefore whether the resource meets the definition of Distributed Renewable Energy Resources.

Cost Recovery Mechanisms

- *“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, [the Commission is] 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”). [The Commission believes] 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, [the Commission] 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, [the Commission] will consider more immediate requests [to] pass these costs through the mechanisms as part of our review of the utility’s feed-in tariff proposal.” Page 4, Paragraph 4*

Purchased power agreements (PPAs) of electric energy executed as a result of the Company’s proposed FIT programs would be recovered through the Company’s current Power Supply Adjustment mechanism (PSA) in conjunction with the RES adjustment mechanism. By administrative rule, only those PPA costs above the cost of comparable conventional generation (CCCG) are allowed recovery through the RES adjustment mechanism (“above market” costs).¹¹ The remaining costs related to renewable energy procured through PPAs are recoverable through the PSA.¹² The allocation of costs between these mechanisms for each individual contract is determined at execution. Based on APS’s experience with renewable generation PPAs, the Company’s proposed Small Generator Standard Offer program requires between approximately \$40 million and \$90 million to be collected through the PSA to complement the \$10 million budget for above market costs collected through the RES. For example, if the \$10 million program budget acquired energy at a 20% premium to market, the remaining market cost of CCCG (\$50 million) would be collected through the PSA.

¹¹ A.A.C. R14-2-1808(B)(4). The CCCG is defined in A.A.C. R14-2-1801(K) as the “...energy and capacity cost of producing or procuring the incremental electricity that would be avoided by the resources used to meet the Annual Renewable Energy Requirement...”

¹² APS’s currently effective PSA Plan of Administration (“POA”) allows for the recovery of all purchased power costs recorded in FERC Account 555, Purchased Power. The Company’s POA was approved by the ACC in Decision No. 71448 (December 30, 2009).

Kristin K. Mayes, Chairman

July 9, 2010

Page 7

Renewable resources funded through the Powerful Communities program would be offered a standard fixed price of \$0.195/kWh for a 20 year production contract. If approved as proposed, the costs of contracts executed through Powerful Communities would be recovered through a combination of the PSA and RES adjustment mechanisms as described above. As filed in the Company's 2011 Implementation Plan, the Company's proposed annual budget reflects between approximately one-third and one-half of the total annual commitment necessary to accomplish the program. The one-half to two-thirds of program costs not collected through the RES proposed budget would be collected through the Company's PSA. APS believes this method is consistent with other projects approved as part of the Company's wholesale distributed energy program.

If you have any questions regarding these comments, please feel free to contact me at (602) 250-2154.

Sincerely,



Eran Mahrer

EM/bgs

cc: Commissioner Gary Pierce
Commissioner Paul Newman
Commissioner Sandra D. Kennedy
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