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TO: The Arizona Corporation Commission

FROM: Virinder Singh, Director—Regulatory and Legislative Affairs, enXco, Inc.

DATE: November 5, 2010

DOCKET NO: E-01345A-10-0262 and E-01345A-10-0166

REGARDING: APS Proposed 2011 REST Implementation Plan and Chairman Kris Mayes October 21, 2010 Letter

enXco Development Corporation (enXco) appreciates the opportunity to comment on Arizona Public Service's (APS) proposed 2011 REST implementation plan. We support APS' overall effort to procure small, wholesale renewable energy generation, including solar photovoltaic (PV) generation. Arizona's tremendous solar resource, sharp peak retail electricity prices during periods of high solar insolation, environmental imperatives, and economic development plans make assertive utility procurement of solar generation a wise decision for Arizona ratepayers and citizens.

We also greatly appreciate Chairman Mayes' consideration of bid deposit levels and the challenge of assessing project viability overall as utilities procure wholesale power from small renewable energy projects. enXco is greatly concerned about the growing list of solar generation projects in the Western U.S. that have entered into utility contracts yet have not materialized well past their initial planned commercial operation date (COD).

Some of our comments below are also found in an earlier letter to the Commission. We include them below to emphasize their relevance to utilities' REST Implementation Plans.

ASSESSING PROJECT VIABILITY IN UTILITY RFPs FOR WHOLESALE SOLAR HAS BEEN AN UNMET CHALLENGE

There has been a perfect storm in the solar industry that favors a "race to the bottom" in the RFP process: that is, power purchase agreements (PPAs) priced well below what is required to support projects with proven technologies at rates supported by the financing markets. In some cases, the cause is pure speculation by developers. In other cases, emerging technology companies, venture-funded and under pressure to demonstrate "market traction", rely on internal engineering estimates of technologies that have not been constructed to scale and carry substantial risk.

To illustrate the scale of the problem, under California's renewable portfolio standard, 1,436 MW of solar projects that have received power purchase agreements (PPAs) have been cancelled, delayed or withdrawn, while only 41 MW have actually begun operation.¹

It is clear that the problem of project viability is plaguing the large-scale solar generation market. The relative novelty of large-scale solar projects appears to challenge bid evaluators, regulators and other stakeholders who cannot refer to enough existing projects in a mature market to determine realistic pricing for equipment, EPC contracts, financing, land, and other inputs.

Absent truly functioning viability "evaluation filters" for project bids, which utilities and regulators have not yet found the secret formula for in the solar market, policies such as assertive utility procurement of wholesale solar generation are likely to result in more speculative bidding and failed projects, instead of competitive bidding of real projects.

The consequence of high rates of project failure is failed attainment of renewable energy goals, failure to deploy solar PV so as to help the steady reduction in costs due to manufacturing economies of scale, foregone employment of local labor, and, most important, a failure to meet ratepayer needs.

As a straightforward solution to project viability, instead of burdening bid evaluators with the challenge of determining project viability in a nascent market with uncertain financing, we strongly urge that the burden of proof of project viability shift to bidders.

APS'S MOST RECENT RFP FOR SMALL RENEWABLE WHOLESale GENERATION REQUIRES MODIFICATION TO ENSURE THAT REAL PROJECTS MATERIALIZE

APS released an RFP for renewable energy small generation resources, on April 27, 2010, and refers to it frequently in the proposed 2011 REST Implementation Plan. If the RFP is to serve as a template for future procurement, it is important to examine the RFP for its project viability screens. The RFP attempted to address project viability with several requirements:

- The proposed technology "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."²
- COD requirements are no later than December 31, 2012 for PV and wind projects, and December 31, 2013 for all other projects.
- A qualitative analysis by staff of "risk factors such as financial, regulatory, counterparty credit, transmission, operations, and project development."³

¹ Derived from California Public Utility Commission RPS Project Status Table, August 2010.
<http://www.cpuc.ca.gov/PUC/energy/Renewables/index.htm>

² Arizona Public Service 2010 Request for Proposal for Renewable Energy Small Generation Resources, April 27, 2010, p. 6.

³ Ibid, p. 16.

Clearly APS is attempting to address project viability with the above measures. However, we find the above measures to fall short of adequately discerning between projects that are real versus those that are speculative.

- The technology-based threshold is very low. Many technologies are in operation at a 100-kW scale, though this would include technologies operating in test beds for research and development (R&D) purposes, rather than as commercial technologies. Future RFP must ensure investment in mature, commercial technologies, as R&D is addressed in other components of Arizona utilities' REST Implementation Plans.
- While the COD requirements do provide impetus for developers to get their projects in the ground, there is no assurance that extensions will not be granted, as is practiced frequently by California utilities.
- Finally, the role of the qualitative analysis by staff in the overall scoring process is unclear. The lack of clarity is compounded by a statement in the same RFP that "the Company may choose to do an initial screening of the proposals based on price alone." A price-only screen would effectively eliminate sufficient screening of projects based on viability. Similarly, an underweighting of "qualitative" viability analysis versus price will also encourage underbidding and poor viability safeguards for bid selection.⁴

Serving as a contemporary success story in ensuring project viability, the Canadian province of Ontario's feed-in tariff requires a series of fees or deposits at three stages: an application fee at the bid stage (\$20/kW), security posted upon contract execution (\$50/kW), and security posted upon a notice to proceed (\$75/kW). Each deposit is refundable to the bidder upon successful completion of requirements at each stage, and is lost if the bidder fails to perform what it has committed to doing for internal reasons, including the failure to secure financing.

The Ontario Power Authority adopted its phased approach after it experienced high levels of bidder failure during its standard offer program between 2006 and 2008, as a considerable portion of 1,400 MW of projects failed to materialize after selection. Ontario adopted the above security fee schedule since it was "necessary to ensure that 'serious' projects keep moving forward" in the wake of a high rate of project failure among projects selected in two previous standard offers.⁵ Anecdotal reports indicate that the \$50/kW deposit level upon contract execution resulted in hundreds of MW of projects falling off, with many more passing through towards fruition.

SPECIFIC RFP DESIGN ELEMENTS SHOULD BE INCORPORATED IN APS'S SMALL GENERATOR STANDARD OFFER PROGRAM TO ENSURE THAT AWARDED PROJECTS ACTUALLY GET BUILT

⁴ Ibid, p. 14.

⁵ John Dalton, Power Advisory LLC (Consultant to Ontario Power Authority). "Assessment of Ontario's Green Energy Act and Its Implications for Ontario." PowerLogic ION Users Conference 2009. October 23, 2009. Paul Gipe. "Ontario's Proposed Feed-In Tariff and OPA's FIT Process." June 4, 2009 presentation. Slide 79.

APS' proposed Small Generator Standard Offer program offers a strong vehicle for proactive procurement of valuable solar generation for ratepayer benefit. However, we believe it is essential to implement a comprehensive, well thought out RFP design to ensure that projects that are awarded PPAs actually get built.

At the heart of a well designed RFP structure is a robust deposit requirement with real teeth to ensure project viability. Furthermore, to deter bid speculation, there should be few "outs" to the developer to recover the deposit if it fails to bring the project to timely operation.

Key elements on the overall RFP process design should include:

- A financeable, standard offer PPA contract that is negotiated in partnership with the IPP industry ahead of the RFP, approved by the ACC, and made available to bidders in the RFP.
- A competitive bid process.
- Selection of winners based on the key criteria of price.
- A 30-day window after winner notification to execute the standard offer PPA.
- A \$100/kW deposit upon execution of the PPA. We believe \$100/kW is preferable in Arizona's context compared to Ontario's deposit levels, since the proposed solicitation would feature more rapid timelines for development, and a higher deposit level enables a rapid process. Further, the 30-day "no regrets" period for the bidder prior to posting the deposit mitigates its impact on viable projects, while screening out unviable projects.
- An 18- to 24-month timeframe to achieve commercial operation after contract finalization. Such a timeline increases project certainty, allowing for more competitive pricing.
- No PPA price renegotiation allowed
- Deposit is refundable upon completion of requirements and achievement of COD
- Beyond achievement of COD, deposit is also refundable only for reasons related to force majeure, unforeseen permitting challenges, and/or overly lengthy interconnection costs or timelines unforeseen at the time of the bid.

The above structure will force developers not to "guess" or to "hope" that they can deliver on a successfully awarded project, but rather, to develop their project ahead of the bid process and have firm line of sight to the cost of equipment supply and financing in the market prior to bidding. Importantly, the 30-day window between bid award and PPA execution should provide ample time for the developer to make the necessary hedges in the markets for commodity prices and debt financing to ensure successful delivery of the project within the 18-month window.

Absent such a structure with meaningful consequences for failure, the onus will continue to be on the purchasers and regulators, and not on the bidder, to ensure viability. The need for bid evaluators to create bright lines (e.g., X number of hours of operation, Y number of projects in commercial operation, Z projects in a developers' portfolio) adds a sense of arbitrariness to viability assessment that can lead to legitimate second-guessing of results among stakeholders.

Some parties express concern about the potential of higher deposits to lock out small developers. We stress that there are many programs in Arizona targeting residential and small commercial projects that offer many opportunities for developers of all sizes. Furthermore, when real projects are denied the opportunity to be built due to speculative projects that fail, ratepayers fail to benefit, while thousands of everyday people are denied the opportunity for meaningful work.

enXco strongly supports a vibrant and competitive solar market at the residential, commercial and utility-scale levels. Solar's diverse application is a strength that contributes to stability in market demand and opportunities for a wide range of developers and installers to thrive for the benefit of their customers. However, we must also stress that renewables procurement policy should primarily serve ratepayers through new, clean generation, rather than as a small business incubator at heavy ratepayer risk of underperformance.

A STANDARD OFFER THAT SELECTS BEYOND VIABILITY AND PRICE CAN UNDERMINE THE STRENGTH OF THE STANDARD OFFER APPROACH

APS proposes that it "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)."⁶ We are concerned that the addition of a vague "value" criterion to bid evaluation runs contrary to the reason for offering a standard offer RFP.

The strength of a properly designed standard offer is its ultimate focus on price (once a strong viability screen is built in to the RFP):

- For bidders, the price focus creates simplicity and clarity, with minimal transaction costs including no renegotiation.
- For regulators and the public, it offers a high level of transparency with price as a clear criterion that does not require complicated conversion of qualitative factors into a quantifiable comparison among bids.

The examples of higher value projects in the APS proposal raise numerous questions, including:

- What a "high value partnership" is, particularly since APS is proposing programs that will target specific groups (e.g., Powerful Communities), and
- Which projects facilitate local job creation (e.g., an in-state PV content requirement standard), including how bidders are quantifying job benefits (e.g., labor entailed in input manufacture, engineering and design, installation, O&M).

We urge that any standard offer program in Arizona avoid such non-price factors that raise the types of evaluation and selection complications that a standard offer should avoid.

⁶ Arizona Public Service, Supplemental Filing, Docket. E-01345A-10-0262 and E-01345A-10-0166, October 13, 2010, Exhibit A, p. 10.

SUMMARY

enXco strongly supports a vibrant and competitive renewable energy market in Arizona, including development of abundant solar resources. Our above comments seek to improve upon existing efforts as utilities, regulators and suppliers all seek to achieve a goal of clean, renewable generation for ratepayer benefit. In particular, strong project viability safeguards in the form of meaningful bid deposits will appropriately place the question of viability on the bidder, rather than the evaluator, so that real projects are built in a timely manner, rather than squeezed out by speculative bidding that fails to serve the needs of ratepayers and the Arizona public.

Thank you for the opportunity to comment. Please feel free to contact me at (503) 219-3166, x1025 with questions.