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August 29, 2014

Susan Bitter Smith, Commissioner
Arizona Corporation Commission
1300 West Washington Street
Phoenix, Arizona 85007

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Arizona Corporation Commission

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AUG 29 2014

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Re: APS Supplemental Application – 2014 RES Implementation Plan
E-01345A-13-0140

Dear Commissioner Bitter Smith:

Thank you for your August 14, 2014 letter. APS appreciates the opportunity to provide additional information regarding APS's 20 MW DG proposal. I answer your questions below.

1. Does APS need 20 MW for its Arizona Sun program in order to meet its 2015 renewable energy requirement?

APS needs the 20 MW to ensure that it complies with the Commission's order in Decision No. 71448 and APS's obligations under its 2009 settlement agreement. Decision No. 71448 requires that APS procure an additional 1,700,000 MWh of renewable energy, beyond 2008 commitments, by the end of 2015. APS might reach this requirement based on estimated third-party installation activity. But it might not. APS will never hit the exact energy target required by Decision No. 71448. The only question is the amount of energy above the end-of-2015 target for which APS should plan. An additional 20 MW of AZ Sun is a reasonable amount that would ensure APS achieves compliance, but not exceed the target by too much.

If APS did not install the 20 MW of AZ Sun, APS would be forced to rely upon third parties to achieve compliance. But in light of known risks to those third parties—such as the U.S. Treasury Department and Internal Revenue Service's investigations into the activities of the largest third-party rooftop solar installer in Arizona—it would be inappropriate for APS to assume that third parties will continue to install solar at today's pace. To ensure compliance with the Commission's order and to fulfill APS's

obligations to the parties who signed the 2009 rate case settlement, APS cannot delegate its responsibilities to the market.

2. What is the time line and process for implementation of the proposed Utility-Owned DG program?

The timeline and process can be broken down into three stages. The first stage involves APS sending a Request for Information to all solar installers in Arizona to determine their interest and ability to participate in the upcoming request for proposal. Through this RFI process, APS will select a “short list” of installers who will then participate in the RFP process described below. The estimated key RFI dates are shown in the following table:

Installer registration open to Power	07/28/2014
Open RFI	09/03/2014
Bidder conferences	09/05/2014
Close RFI	09/17/2014
Evaluation complete	09/26/2014

The second stage is the RFP process in which APS will select qualified local solar installers in a competitive bid framework. An independent monitor will oversee the RFP process and result. The estimated key RFP dates are shown below:

Open RFP	09/29/2014
Bidder conferences	10/01/2014
Close RFP	10/27/2014
Awarded (installation process begins)	12/05/2014

The final stage will involve the actual construction of the DG systems by the installers selected during the RFP process. The construction phase is scheduled to begin in December 2014 and conclude by the end of 2015.

- a. What are the plans for the customer solicitation? Will all customers receive notice regarding the program, or will the notice be targeted? If the latter, how will the targets be identified? What criteria will be used to identify targeted areas? Will this program be targeted in rural or urban areas? What criteria will be used to select customer participants?**

On July 28, APS initiated a “customer interest list” that involves collecting the names, addresses and contact information of interested customers who have heard about the

program through media coverage, on aps.com or otherwise. As of this letter, over 1,000 customers have indicated their interest in the program. APS expects this list to grow as media coverage and word of mouth continues. Being on this list, however, does not place a customer "in line" for the program. Instead, APS will use this list to both contact customers by email following a decision about the program and help APS evaluate locations of high interest for targeted marketing, if needed.

Following approval of the proposed project, APS will pursue additional marketing efforts that may include:

- Creating dedicated pages on aps.com for complete program details and a link to the customer application system;
- Messaging in customer communication channels, including the monthly newsletter, bill messaging, the customer contact center and customer offices; and
- Disseminating an information packet with program details at various customer outreach events, such as trade shows or local community events.

APS will select customers on the basis of where customers are located and when they sign up for the program. To be eligible, a customer must meet certain objective program requirements, such as whether their rooftop can viably hold a DG system. But all customers will otherwise be eligible for the program, regardless of credit score or income level. Regarding customer location, APS will strategically target systems. The Company is currently identifying potential strategic areas, which could include rural locations within APS's service territory. If APS identifies areas for strategic placement, it will solicit customers in those areas with marketing efforts that may include door hangers and onsite HOA or neighborhood presentations.

b. Will this program be available to tenant based buildings or rentals?

This program will be available to APS customers who rent their homes with the agreement of the homeowner. The homeowner will ultimately sign the easement granting APS access to the rooftop. The program is not designed for multi-tenant housing, such as apartment complexes.

3. How does APS plan to select solar installers? Will the RFP process be conducted by APS or by a third party contractor? How will APS develop the criteria for contractor selection?

Similar to other AZ Sun projects, APS will solicit installers through a competitive RFP process that will be monitored by an independent third party. As discussed above, APS

will initially conduct an RFI to create a "short list" of installers, who will then compete in the RFP process. Criteria for the RFP are being developed based on APS's experience with other AZ Sun projects, the Community Power Project and the Schools and Government Program. The potential criteria include:

- Number of years in business
- Number of installations completed
- Number of systems currently under warranty
- Company headquartered in Arizona
- Number of years paying Arizona income taxes
- Safety record
- BBB rating
- AZROC licensing, and the number and resolution of complaints
- Training certifications of staff
- Strength of supply chain

APS continues to work with the local installer community to ensure that the RFP requirements allow for the maximum amount of local installer participation while maintaining the highest standards of quality.

4. What were the costs for the Flagstaff demonstration project?

The Flagstaff Demonstration Project was a research project, conducted with the Department of Energy, to test what happens when a large amount of distributed solar is installed on a single feeder. The Flagstaff Project included facilities and expenses associated exclusively with the research aspect of the endeavor. In addition, the Project was built in 2011. And although APS obtained the best available market price at the time through a competitive solicitation of third-party installers, the bids received still reflected 2011 prices for installing solar. Given the research nature of the Project, and that the Project was built in 2011, cost information regarding the Flagstaff Project is of limited value when assessing DG costs in 2014. Nonetheless, the total costs for the Flagstaff Project to date have been approximately \$12.1 million.

5. What liabilities will APS and the rate payers undertake with the deployment of APS owned facilities on private rooftops? Will APS acquire liability insurance to protect against risks to private property?

The risks associated with the AZ Sun DG program are no different than those experienced third-party solar installers. A key difference, however, is that APS currently owns facilities throughout every neighborhood in its service territory, facilities that connect with every single customer's home. APS has deep experience on how to safely

and effectively operate utility-owned facilities on customer property in a manner that minimizes disruption to customers' day-to-day routines. Nonetheless, to manage the minimal risk associated with any liabilities that might emerge with AZ Sun DG, APS would acquire liability insurance. The additional cost for that insurance is estimated to be approximately \$50,000 a year for the entire project.

6. Why should this Utility-Owned DG program be deployed through the regulated operations of APS and not via a non-regulated subsidiary such as your previous entity APS Energy Services?

AZ Sun DG was proposed through regulated operations for several reasons, the first of which is precisely because APS is regulated. There is no question where customers should go if they have questions about the DG on their roof or feel that they have been treated unfairly. And customers know that APS will be here next year, and in 30 years. As a company that has been in Arizona for 125 years, customers have no concerns about entering into 20 year agreements with APS.

In addition, the market has simply failed to provide solar to customers with bad credit or low income. As a public service corporation, APS is not driven by profit in the way that third-party leasing companies are. APS doesn't only serve the higher income segments of the public. APS will transact with all customers, regardless of income or credit.

Moreover, pursuing rooftop solar through an unregulated company requires relying on a precariously balanced set of tax-advantaged financing. It is not clear how the IRS's investigation into rooftop solar tax-based financing may conclude. Given that uncertainty, commencing a rooftop solar business that depends on tax-advantaged financing being increasingly available may not be the wisest decision.

Finally, APS proposed AZ Sun DG through regulated operations because solar is only economically viable in unregulated operations if it is coupled with net metering. But as the Commission noted in Decision No. 74202, net metering shifts costs, which "then must be picked up by non-DG customers either through higher energy rates or through other mechanisms..."¹ It would be unfair to APS's 1.1 million customers without solar for an APS affiliate to engage in a business model that relies upon net metering, forcing those 1.1 million customers to unfairly pay an even greater share of the grid's fixed costs.

¹ Decision No. 74202 at P 21 (December 3, 2013).

Susan Bitter Smith, Commissioner

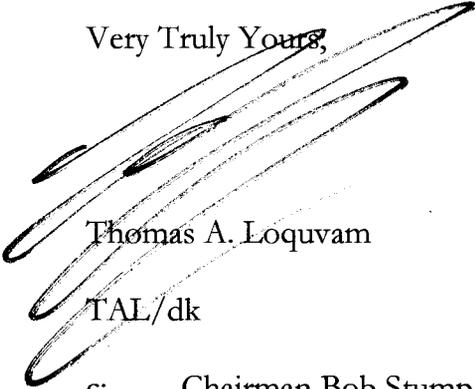
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Until rates are designed in a manner to make rooftop solar fair for everyone, AZ Sun DG involves only a \$30 monthly payment to participating customers. This payment is not an avoided fixed cost, but instead the same as any land acquisition payment APS would make to a third-party land owner for the purposes of siting generation on that third party's land.

Thank you for your letter. APS appreciates the opportunity to clarify details regarding the AZ Sun DG program. Please feel free to contact me with any additional questions.

Very Truly Yours,



Thomas A. Loquvam

TAL/dk

c: Chairman Bob Stump
Commissioner Gary Pierce
Commissioner Brenda Burns
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Susan Bitter Smith, Commissioner

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