BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Continue Implementation and Administration of California Renewables Portfolio Standard Program.	Rulemaking 11-05-005 (Filed May 5, 2011)

REPLY COMMENTS OF THE INDEPENDENT ENERGY PRODUCERS ASSOCIATION ON THE RPS PROCUREMENT PLANS

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In keeping with the schedule established in the *Assigned Commissioner's Ruling Identifying Issues and Schedule of Review for 2012 Renewables Portfolio Standard Procurement Plans Pursuant to Public Utilities Code Sections 399.11 et seq. and Requesting Comments on New Proposals,* dated April 5, 2012 (ACR), the Independent Energy Producers Association (IEP) offers its reply comments. IEP will reply to comments on only some of the topics covered in the parties' opening comments on the Renewables Portfolio Standard (RPS) procurement plans of the three largest investor-owned utilities (IOUs), Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E).

I. INTRODUCTION

In its opening comments, IEP noted that reducing the lengthy time between the initial Request for Proposals (RFO) to final Commission approval of a PPA, a process that can take 18 months or more, is crucial to improving the RPS procurement process. This lag means that prices bid initially into the RFO are likely to become stale and can become "out of market" by the time the Commission acts on the power purchase agreement (PPA). As a result, the Commission is repeatedly faced with comparisons between the price terms of fully negotiated and executed PPAs and bids submitted in new RFOs, bids that are sometimes based on estimates or hopes rather than realistic assessment of the ultimate costs of bringing a project into operation. To address this problem, IEP urged the Commission to (a) commit to timely decision-making with the goal of issuing a final decision on a PPA within 120 days of the date the utility submits the PPA to the Commission for approval, (b) emphasize project viability relative to price in bid evaluation, and (c) allocate risks to the party in the best position to manage the risk.

IEP particularly urges a greater emphasis on project viability as a means to reduce the high rate of project failure. Projects that fail because developers submitted bids that were unrealistically low in competitive solicitations can displace bidders that submitted more realistic higher bids and that have a better chance of achieving commercial operation.

IEP similarly urges the Commission to ensure that bid evaluation methodologies take account of the risks associated with the potential loss of federal tax credits for renewable generation. The risks associated with selecting less mature projects are increased in this procurement cycle because the federal investment tax credit (ITC) is scheduled to expire at the end of 2016. The ITC translates into a 30% discount on the cost of constructing a renewable energy project, and that discount will also be reflected in lower bids from the eligible projects and in lower prices for ratepayers. Ratepayer will lose this benefit if a project fails to begin operation by 2016 and displaces a more viable project that is able to qualify for the ITC before it expires.

Because of the inherent uncertainty about whether any federal tax credits will be available after 2016, the Commission should allow bidders (and ratepayers) to hedge this risk by allowing bidders to submit two bids for different tax credit outcomes: (a) if no federal tax credits are available after 2016, and (b) if tax credits are available in some form.

At the same time, the long lead-times contemplated in the RPS plans create additional risks for project developers, as the economic, legal, and regulatory environment changes in unpredictable ways. Some significant components of these risks are well beyond the developer's control. For these few bid components, additional flexibility must be inserted into the RPS procurement plans and the associated pro forma PPAs.

II. EXPIRATION OR EXTENSION OF THE PRODUCTION TAX CREDIT AND INVESTMENT TAX CREDIT

The federal ITC and Production Tax Credit (PTC) have reduced the effective cost of initial capital investments in generating facilities over the last few years. California should not miss the opportunity to access this federal funding as long as it remains available, because these credits provide significant benefits to California consumers and ratepayers. However, whether the ITC, which expires in 2016, and PTC, which expires at the end of 2012, will be extended is a controversial political question that is not currently resolved. The extension of these credits is in the hands of Congress and the President, and clearly the outcome is not in any way under the control of the individual developer bidding into an RPS solicitation. In light of the uncertainty about the future of these credits, the Commission should provide guidance to the utilities about how to conduct procurement and manage renewable energy procurement costs in the uncertain post-2016 period. This guidance should include informing the utilities about how to evaluate bids from projects with a COD of 2016 or earlier, and directing the utilities to provide for two-part bids for projects with an expected COD after 2016, based on whether the federal tax credits are available or not.

PG&E proposes to address the uncertainty about the continuing availability of these federal credits by eliminating the Tax Credit Mitigation Option that it previously made available to renewable developers. The former option allowed developers to seek price adjustments if the ITC/PTC were to expire. PG&E contends that eliminating this option will lead to offers "from developers who are committed and able to fulfill contractual requirements without the guarantee of financing subsidies."[1] The Division of Ratepayer Advocates supports PG&E's proposal to eliminate the Tax Credit Mitigation Option. DRA believes this revision "would require projects to be financially more self-sufficient and less reliant on subsidies."[2]

Both PG&E and DRA miss the point. Regardless of whether a project is financially self-sufficient or not, the federal tax credits provide a way for projects to reduce their net costs, which in turn will allow them to bid a lower price in competitive solicitations, resulting in significant savings for ratepayers. As long as the federal credits remain available, it would be foolish for developers of California projects not to take advantage of them to lower their costs and to pass the benefit of those lowered costs on to ratepayers in the form of lower bids to supply renewable energy.

IEP presumes that the least-cost/best-fit (LCBF) bid evaluation methodology properly values the availability of the federal tax credits (*i.e.*, bids should reflect the potential for a 30% credit if the project's commercial operation date (COD) is achieved before 2017 versus no federal tax credits for projects with later CODs). The LCBF methodology should send the appropriate signals to utilities regarding whether or not to transact with developers that can take advantage of federal tax credits. If the LCBF bid evaluation methodology does not reflect the benefit of the federal tax credits, then it should be updated to take these benefits explicitly into

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[1] PG&E's 2012 Plan, pp. 14-15.
[2] DRA's Comments, p. 15.

account. At a minimum, the Commission should provide the utilities with enough procurement flexibility to maximize the benefits that ratepayers receive from these federal credits through lower prices from projects able to use these credits to reduce costs.[3] In making this determination, the Commission should seek to maximize the benefits for ratepayers by weighing the current provisions on the ITC against any potential costs of accelerated procurement, the possibility that the ITC will be extended, and price trends and possible technological advances after 2016.

The current uncertainty about the future of these federal credits creates a risk that will be reflected in higher bid prices unless the risk can be managed. In its opening comments, IEP noted that bidders who plan for a commercial operation date in 2016 in order to take advantage of the availability of the ITC should have the flexibility to specify a later delivery date in their bids to better match the RPS delivery need of the utility. The Commission should authorize utilities to accept bids from projects that propose to commence delivery to the utility after the year in which they begin commercial operation, so projects that are position to receive the benefits of the tax credits by beginning commercial operation prior to 2017, for example, can commit to deliveries to the utility in the third compliance period when the utility may have a greater need for renewable energy.

IEP also proposed that bidders with commercial operation dates after 2016 should submit two bids: one bid assuming no extension of the federal credits, and a second bid reflecting the price the bidder is willing to accept if the PTC and ITC are extended. Under this proposal, developers will have no basis for asking to reopen the PPA's price term if the ITC/PTC are not renewed, and conservative developers will not be penalized for submitting bids that do not assume the continuation of the ITC/PTC. The reopener and second round of negotiation

[3] Comments of the Large-scale Solar Association, p. 3.

inherent in PG&E's Tax Credit Mitigation Option is eliminated, and ratepayers are assured of receiving the benefit of the credits as long as they are in effect.

III. INTEGRATION COSTS

A. Integration Cost Adders in the Context of LCBF Bid Evaluation

Several parties commented on the utilities' proposals for including the cost of integrating renewables into the existing grid as part of the bid evaluation of specific projects. In general, IEP supports including integration costs as part of the LCBF bid evaluation criteria as long as the integration cost adders have been subject to public review, comment, and scrutiny. In its opening comments, IEP noted that PG&E's proposed integration cost adder for projects using "intermittent" technologies did not appear to have any empirical basis and would be applied in a crude way to all projects considered "intermittent." Other parties emphasized the need for an open, transparent, and public process for identifying and quantifying any integration costs.[4]

IEP distinguishes the use of integration cost adders for purposes of LCBF bid evaluation, as discussed above, from the imposition of integration costs on generators, particularly costs that are unknown, unknowable, and not likely to be a function of actual generation. IEP has noticed that the discussion of integration costs has recently focused on the need for fast-ramping resources to respond to changes in the morning and late afternoon, as solar resources and wind resources in some locations increase or decrease their output. However, the discussion of morning and evening ramps has so far largely omitted a discussion of the role of customers' consumption patterns on perceived integration problems. Customers' consumption, or load, also affects the net variability of the supply-demand balance, and focusing solely on

[4] Comments of BrightSource Energy, Inc., second page of comments; comments of the Large-scale Solar Association, pp. 2, 5-7.

supply-side resources overlooks the opportunity to use demand-side resources to address the perceived problem of variability.

Furthermore, even in the context of applying integration cost adders for purposes of LCBF bid evaluation, the evaluation should include consideration of the benefits provided by a resource base that is increasingly diversified in terms of fuel, technology, location, and operational characteristics. That is, the costs of renewables integration should be the net costs, after consideration of the benefits these resources offer to the grid.

B. Integration Cost Allocation and Recovery

Regardless of how integration costs are calculated, the amount of and grounds for any potential integration charges that the California Independent System Operator (CAISO) may eventually impose on renewable generators are currently unknown and unknowable to developers. Many parties in the CAISO's stakeholder process have acknowledged the need for, and value of, allowing sellers to pass-through to buyers any integration costs directly allocated to generators by the CAISO as a means of sending better market price signals at the time of procurement. However, the current pro forma PPAs proposed in the utilities' RPS procurement plans have no provision that describes how integration charges would be allocated. Under these circumstances, IEP reiterates the need for a non-modifiable standard provision in the pro forma PPAs along the lines of the provision IEP proposed in its opening comments.[5]

IV. PRELIMINARY INDEPENDENT EVALUATOR REPORT

The Assigned Commissioner's Ruling proposed to institute a preliminary Independent Evaluator's Report on bid solicitation materials that would analyze the reasonableness, accuracy, strengths, weaknesses, and fairness of the bid solicitation materials

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[5] *I.e.,* "Unless otherwise specified in this Agreement, any charges imposed on Seller by the CAISO, pursuant to its tariff, to recover costs that the CAISO determines are required to integrate increasing levels of renewable resources into the CAISO-controlled transmission system shall be compensated by Buyer." IEP's Comments, p. 9.

and the criteria for the LCBF analyses, and evaluate how the LCBF criteria are used in bid evaluation. In its comments, Tenaska Solar Ventures (Tenaska) supported this proposal because Tenaska believes the preliminary report of the independent evaluator (IE) will increase the transparency of bid evaluation.

While IEP has long advocated for greater transparency in bid evaluation, IEP continues to have reservations about whether this proposal will have any practical effect. The Commission's confidentiality policies limit access to a wide range of information deemed "market-sensitive," including much of the existing IEs' reports, and without a change in those policies, bid evaluation will continue to be hidden behind a shroud of confidentiality.

Adding a preliminary IE report to the procurement process also raises concerns about delay. All aspects of the proposed preliminary IE report must be carefully integrated into the procurement process so that an already-lengthy process does not become even longer.

If the preliminary IE report actually increases the transparency of the procurement and bid evaluation process to the public and does not unduly slow down the procurement process, it could be useful. For example, as Ormat Technologies points out, the IE could ensure that the needs and requirements, or "products," sought by the utilities are specifically defined, so that bidders can tailor their proposals to match the utility's specific needs.[6]

V. CREATE TWO SHORTLISTS BASED ON STATUS OF TRANSMISSION STUDY

The Assigned Commissioner's Ruling proposed to create two shortlists. The Primary Shortlist would consist of projects that have executed Interconnection Agreements or have obtained Phase 2 interconnection study results from the CAISO. The Provisional Shortlist would consist of all other shortlisted bids. As projects from the Provisional Shortlist obtained

[6] Comments of Ormat Technologies, p. 4; see Comments of CalEnergy Generation Operating Company, p. 19.

their Phase 2 study results, they would migrate to the Primary Shortlist. Only PPAs with projects from the Primary Shortlist could be executed and presented to the Commission for approval.

Tenaska contends that the two-shortlist approach will help "eject speculative projects from utility solicitations." However, the Commission has other, more precise tools to weed out speculative projects. The two-shortlist proposal gives the utility the ability to designate a large number of projects for the Provisional Shortlist, and to prevent them from competing in other solicitations or from negotiating with other potential purchasers, only to drop them from the shortlist after twelve months (if another of the new proposals is adopted). Having two shortlists also puts a premium on completing the Phase 2 interconnection studies (the pace of which is largely out of the developer's control) over a broader least-cost/best-fit evaluation. An additional consideration is that the interconnection study process of the CAISO is still evolving, and it is not certain that the Phase 2 studies required to graduate to the Primary Shortlist will always be completed on time.

Thus, the two-shortlist approach would lead to less efficient procurement and unnecessary delays, not to the increased efficiency of procurement that Tenaska foresees. The Commission should not adopt the two-shortlist approach.

VI. 12-MONTH EXPIRATION OF SHORT-LISTED CONTRACT PROPOSALS

In comments, Tenaska supported the proposal to create a 12-month expiration date for short lists and urged the Commission to clarify that parties must negotiate in good faith. IEP continues to be concerned that this proposal is infeasible and impractical because it sets an arbitrary deadline, and directing parties negotiate in good faith will not solve the core problem. The core problem is that negotiations can be delayed for any number of reasons even if all parties negotiate in good faith. The downside of this proposal is that it could strand many nearly complete negotiations due to an arbitrary deadline. The 12-month deadline will potentially provide unwarranted leverage to one party to the negotiations as the deadline nears. While IEP agrees that bilateral negotiations ought to be expedited and that delays lead to stale bids, arbitrary deadlines like the 12-month deadline for negotiations can undermine beneficial outcomes.

VII. PG&E'S CURTAILMENT PROVISIONS

The California Wind Energy Association (CalWEA) noted that PG&E's curtailment provisions could result in PG&E having an unlimited ability to curtail generators without compensation. This clearly irrational outcome results from PG&E's expansive definition of "Curtailment Order" to include any warning, forecast, or anticipated overgeneration condition. The CAISO, however, expects to resolve most potential overgeneration situations through market mechanisms, not by issuing warnings, until it encounters actual overgeneration. Under PG&E's definition, a generator could be curtailed without compensation even as other generators are receiving compensation for curtailing in response to market signals.

VIII. SECURITY REQUIREMENTS

IEP supports relatively high, yet reasonable project development security requirements in order to help ensure that non-viable projects do not clog the procurement or interconnection queues. However, high development security requirements can become a barrier to participation in RFOs, and development deposits tie up in an account what otherwise might be useful capital. The Commission should strive for a policy on project development security requirements that balances the need to discourage non-viable projects from bidding in RFOs against the value of maximizing the participation of viable projects and freeing up capital for more productive uses.

PG&E proposed to increase its project development security to $300/kW. While PG&E's proposal will help screen non-viable projects, it also risks becoming a barrier to bidding, and PG&E's proposal was opposed by several parties.

IEP has two comments regarding PG&E's proposal. First, if the proposal is approved by the Commission and if an insufficient number of bidders participate in PG&E's next RPS RFO, then PG&E should be directed to immediately lower the project development security to a more reasonable level, and re-release the RPS RFO as rapidly as possible. Second, because this level of security ties up a significant amount of capital in an unproductive account, the Commission should require PG&E to establish an explicit schedule for reducing the amount of security deposit between submission of the initial project development security deposit and COD, when the Performance Obligation takes effect. The scheduled for reducing the project development security (and returning some portion of the security to successful bidders) could be tied to achieving specific milestones during the development, permitting, and construction phase. Thus, the amount of the security deposit would be directly tied to reduced risk as the project progresses toward COD, and a proportion of the original security deposit would be returned to the developer for more productive uses.

IX. CONCLUSION

In its opening and reply comments on the RPS procurement plans and new proposals, IEP has urged the Commission to (a) commit to timely decision-making on PPAs, with the goal of issuing a final decision on a PPA within 120 days of when the utility submits the PPA to the Commission for approval, (b) emphasize project viability relative to price in bid evaluation, and (c) allocate risks to the party in the best position to manage the risk. In addition, IEP respectfully urges the Commission to:

- authorize utilities to accept bids from projects that propose to commence delivery to the utility after the year in which they begin commercial operation, so projects that are position to receive the benefits of the ITC by beginning commercial operation prior to 2017 remain in consideration even though they may not make actual deliveries to the utility until the third compliance period;

- allow bidders with commercial operation dates after 2016 to submit two bids: one bid assuming no extension of the federal credits, and a second bid reflecting the price the bidder is willing to accept if the PTC and ITC are extended;
- provide guidance about whether and to what extent utilities should accelerate procurement targeted for the third compliance period to take advantage of the current ITC for projects that begin operation by the end of 2016;
- include renewables integration costs as part of the LCBF bid evaluation criteria as long as the integration cost adders have been subject to public review, comment, and scrutiny;
- require the addition of a non-modifiable standard provision in the pro forma PPAs that requires the buyer to compensate the seller for any renewables integration costs the CAISO imposes on the seller, unless the parties agree otherwise;
- ensure that the proposed Preliminary Independent Evaluator's Report is not shrouded in confidentiality and extensively redacted and that the preparation and issuance of the report does not slow down the procurement process;
- reject the proposed two-shortlist approach;
- reject PG&E's proposed curtailment provisions; and
- in setting project development security requirements, balance the need to discourage non-viable projects from bidding in RFOs against the value of

maximizing the participation of viable projects and freeing up capital for more productive uses.

Respectfully submitted this 18th day of July, 2012 at San Francisco, California.

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By */s/ Brian T. Cragg*
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VERIFICATION

I am the attorney for the Independent Energy Producers Association in this matter. IEP is absent from the City and County of San Francisco, where my office is located, and under Rule 1.11(d) of the Commission's Rules of Practice and Procedure, I am submitting this verification on behalf of IEP for that reason. I have read the attached "Reply Comments of the Independent Energy Producers Association on the RPS Procurement Plans," dated July 18, 2012. I am informed and believe, and on that ground allege, that the matters stated in this document are true.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on this 18th day of July, 2012, at San Francisco, California.

/s/ Brian T. Cragg
Brian T. Cragg

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