Feed-in-Tariffs
Keeping track in California

By C Thomas Paschall

In the United States, with the upcoming expiration of the commencement of construction deadline underpinning the Section 1603 cash grant *in lieu* of tax credit under the American Recovery and Reinvestment Act of 2009, it's anticipated state incentive programs and policies will be the next catalyst of renewable energy expansion. States have been, and are expected to continue serving as, classic laboratories of experimentation in achieving energy independence and sustainability.

Among the many state policies impacting renewable energy (such as the newly revised California RPS), Feed-in-Tariff contracts remain important economic and financing tools, particularly for small to mid-sized renewable energy generation projects. Although there may be as much negative press relating to Feed-in-Tariffs as there are favorable reports (often looking at the potential overpricing of such tariffs, as happened in Europe, and administrative difficulties of ensuring competitive pricing by qualified bidders), there's no doubt Feed-in-Tariffs remain critically important to developers and others seeking to be "incentivized" to continue developing independent generation projects.

In the state of California, following in the wake of Governor Brown's announcement of his intention to encourage development of 12 gigawatts (GW) of small-scale distributed generation projects by 2020, and to achieve the 33% RPS, project developers (particularly in the solar industry) have closely monitored progress toward achievement of a sound and effectively managed Feed-in-Tariff program.

Under current California regulations, there are three feed-in-tariff programs either implemented or in process, but approaching finalization of implementation:

1. The AB1969-based California Renewable Energy Small Tariff (CREST) Power Purchase Agreement (PPA) for projects up to 1.5 megawatts (MW) of nameplate capacity;

2. The SB32-driven Feed-in-Tariff for projects up to 3.0 MW; and

3. The Reverse Auction Mechanism (RAM) for projects greater than 1.5 MW, but not larger than 20 MW.

With so many moving parts, the California Feed-in-Tariff programs have arguably had the unintended consequence of creating confusion among developers and financing institutions, as it can be difficult to track the latest status of such programs. This article attempts to add clarity by focusing primarily on recent developments in the CREST PPA program and the RAM.

CREST PPA: Seeking expedited reform before cash grants expire

Until recently, the CREST PPA program has been largely written off as an example of a failed Feed-in-Tariff program, but last-minute revival efforts may create opportunities for projects pursuing CREST PPAs to realize their objectives in time to be "safe harbored" under the Treasury Grant in 2011—while achieving commercial operation in 2012. The original CREST PPA based on AB 1969 was approved in 2008, but it's only achieved a small fraction of the intended Feed-in-Tariff contracts designed for the program. Originally, the issue was a pricing problem. The CPUC Market-Priced Referrent (MPR) was based on the long-term ownership, operating, and fixed priced fuel costs for a new proxy 500 MW natural gas-fired combined cycle gas turbine, with time of day (TOD) adjustments lower than bid-winning and bilaterally negotiated PPA prices.

After solar equipment costs plummeted to their current levels, the MPR-based pricing became more attractive. But, the ability of developers to obtain customary non-recourse project financing from commercial lending institutions in reliance on the CREST PPA proved impossible. The CREST PPA in its original form proved to be unbankable. In particular, the CREST PPA contained regulatory and change-of-law "outs" enabling a contract to be terminated, or pricing altered for reasons outside the seller's control. It also didn't contain customary pledge and assignment clauses in favor of lenders as typically required by banks lending in reliance on long-term power purchase agreements. As a consequence, several years into the CREST PPA program, only 3.35 MW of CREST PPAs had been approved and executed out of a total program capacity allocation of 247.7 MW, at least as of September 13th, 2011 (according to the Southern California Edison website).

On October 11th, 2011, an Administrative Law Judge issued a Proposed Decision granting, with modifications, the Clean Coalition's motion for immediate amendments to the CREST PPA. Notwithstanding SCE's efforts in late 2010, and into the summer of 2011, to establish a process for revising the CREST PPA to cure many of the provisions making it non-financeable—with the CPUC moving toward approval of the new 3.0 MW Feed-in-Tariff referred to above—SCE unilaterally suspended its CREST PPA reform ef-

forts in late July, prompting the Clean Coalition and others to file a motion in August, 2011 seeking Commission approval of certain reforms recommended as of such date in the existing stakeholder process.

In the Proposed Decision, it's recommended the CREST PPA be amended to:

i) Offer a six-month extension in the case of regulatory delays;
ii) Replace the termination section and amendment clause with significantly improved provisions borrowed from the 2010 SPVP contract (removing the regulatory "out" and the ability to modify the contract at the direction of the CPUC);
iii) Insert customary pledge and assignment clauses in favor of lending institutions; and
iv) Insert customary *force majeure* and indemnification clauses.

As of press time, SCE has a near-term deadline to file its comments to the Proposed Decision (October 31st, 2011) and comments to SCE's response will be due a week later. It's anticipated by November 10th, 2011, a final decision will be made in which the utilities will be ordered to issue a Tier 1 advice letter incorporating all relevant amendments into a revised CREST PPA. Consequently, developers with CREST PPA projects may have the opportunity to execute CREST PPAs with greatly enhanced protective provisions as early as November 15th, 2011, and should see their projects enjoy greater likelihood of obtaining traditional non-recourse project financing.

RAM updates

The California RAM program has experienced a wild ride in 2011, commencing with euphoria surrounding its early announcement in the beginning of the year, followed in April by its suspension for 150 days after protests were filed regarding its proposed implementation by the utilities. But, culminating with announcement of the first RAM RFO in September (proposals due no later than November 15th, 2011) has set the stage for the highly anticipated bi-annual RAM RFOs going forward. Interestingly, the RAM pricing may also serve as a pricing benchmark under the SB32 Feed-in-Tariff, although competing proposals continue to be digested by the CPUC regarding the optimal pricing mechanism.

In conclusion, it will be fascinating to see whether the CREST PPA can be finalized and approved before year-end for stranded CREST PPA projects to be: revived, obtain, and executed with interconnection agreements in the remaining weeks of 2011; seek commercial project financing; and, qualify for the Treasury Grant. In addition, the results of the inaugural RAM auction process in mid-November will set the stage for what may prove to be a pivotal Feed-in-Tariff experiment combining the power of market forces with the certainty of a regulated and financeable RAM Feed-in-Tariff PPA. Developers and financing institutions should consult with their counsel and financial advisors to navigate through these critical months and in planning ahead.

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