Alex Neverkovec

From: Diane_Fellman@fpl.com

Sent: Wednesday, September 13, 2006 4:00 PM

To: docket@energy.state.ca.us

Subject: Comments of FPLE Energy, LLC -- 2006 Integrated Energy Policy Report Update -- RPS Mid Course Review: Docket Nos. 06-IEP-1c and 03-RPS-1078

Attachments: FPLE Letter to Commission Geesman on RPS Mid-course Correction 8-22-06 Workshop.pdf

California Energy Commission
Docket Office
1516 Ninth Street, MS-4
Sacramento, CA 95814

DOCKET
03-RPS-1078 06-IEP-1C
DATE SEP 13 2006
RECD. SEP 14 2006

2006 Integrated Energy Policy Report Update -- RPS Mid Course Review: Docket Nos. 06-IEP-1c and 03-RPS-1078

Attached is a letter from FPL Energy, LLC that is being filed electronically in Portable Document Form (.pdf). One paper copy is being hand delivered to your offices today. Please stamp the copy received and return it to the courier when it arrives.

By leave of Commissioner Geesman, FPL Energy was granted an extension to file these comments following the August 22, 2006 workshop until today, September 13, 2006.

If you have any questions, please feel free to contact me at the numbers below.

Diane I. Fellman
FPL Energy, LLC
234 Van Ness Avenue
San Francisco, CA 94102

(415)703-6000 office
(415)703-6001 fax
(415)601-2025 cell

234 Van Ness Avenue
San Francisco,CA 94102
415.703.6000
415.703.6001
diane_fellman@fpl.com

FPL Energy

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Honorable John Geesman
Commissioner
California Energy Commission
1516 Ninth Street
Sacramento, CA 95816

In the Matter of: Informational Proceeding and Preparation of the 2007 Integrated Energy Policy Report	Docket No. 06-IEP-1c
Implementation of Renewables Portfolio Standard Legislation (Public Utilities Code Sections 381,383.5,399.11 through 399.15, and 445 [SB 1038 and SB 1078]	Docket No. 03-RPS-1078 **2006 Integrated Energy Policy Report Update –RPS Mid Course Review**

Dear Commissioner Geesman:

At the California Energy Commission's ("Commission") RPS Mid-Course Correction Workshop on August 22, 2006, you requested that FPL Energy, LLC (FPLE) answer the question why the largest renewable company in the world was not bidding into the Renewable Portfolio Standard (RPS) solicitations in California. You inquired whether:

(1) the development of the ISO's MRTU market will afford us a realistic prospect of taking on a merchant role in California;

(2) the prospect of doing bilateral transactions with the California investor-owned utilities at or below the MPR is an attractive prospect; and

(3) if neither of these is appealing, what changes in the RFO process would it take to have FPLE participate.

This letter responds to that inquiry. As we have stated, FPLE is prepared to invest the capital needed to build new renewable projects as well as repower the existing wind and solar thermal facilities, under the right conditions. FPLE believes that California has been and once again can be the most attractive energy markets for investment, if certain changes in regulatory policy and market structure are made. The current lack of regulatory certainty causes us to have concerns over the long-term attractiveness of the California energy market. If there is greater clarity and regulatory commitment on the matters discussed below, we are prepared to invest significantly and quickly.

Currently, FPLE, through its affiliates and subsidiaries, either owns or operates 700 MWs of wind and 310 MWs of solar thermal in California.[1] We are also committed to the development of our Montezuma wind project in Solano County which won a bid in the 2005 PG&E RPS RFO solicitation[2]. Development of new facilities anywhere is not risk free. Challenges such as the Production Tax Credit (PTC) cycle and wind turbine scarcity -- as well as associated increasing costs of turbines, construction and permitting -- are not in and of themselves sufficient to block investment in California. These challenges exist in all markets throughout the country where wind development is currently going forward. Thus, why is development and financing of energy projects considered riskier in this state? This response addresses your questions and provides one company's view on the changes needed to facilitate investment.

(1) CAISO's MRTU market represents an important step in allowing the development of merchant renewable generation in California; however, development of an Eastern-style capacity market is critical.

In testimony before the California Public Utilities Commission (CPUC), CEERT[3] presented Mr. Anders Glader of PPM Energy and Mr. John Seymour of FPLE as witnesses on the role of markets in developing renewables. In their testimony, they stated:

> ...As markets mature, investors grow more comfortable with that market and various procurement options, and marketers become more sophisticated, there will, and should, be greater opportunities for projects to be developed and financed with less traditional structures as well as long-term contracts....
>
> **How would you describe the current market for renewable generation in California?**
>
> In order for a new renewable resource to be built in California or any state, one of two things must happen: Either (1) a customer (buyer) and developer (seller) must agree on the terms of a financeable long-term contract by which electric generation is procured from this project or (2) the developer and its investors (meaning either a developer's shareholders as represented by its board and

[1] Although not the subject of this proceeding, the principles delineated by FPLE in this letter apply to its existing new combined cycle facility at Blythe, California and its CEC-permitted combined cycle "Tesla" unit in Northern California.

[2] Presentation of PG&E, California Energy Commission Committee Workshop on the Mid-Course Review of the Renewables Portfolio Standard Process., July 6, 2006,

[3] Center For Energy Efficiency And Renewable Technologies (CEERT) , Prepared Testimony: Commercial And Market Realities In Renewables Procurement Contracting; CPUC Rulemaking 06-02-012, May 4, 2006

management, or a developer's external equity and debt investors) evaluate the applicable energy market and conclude that the market will provide sufficient revenues to justify, in light of the risks to which the project will be exposed, undertaking the project...

FPLE believes that a market structure with proper mechanism to manage price and delivery risk such as capacity markets, a liquid energy market and firm transmission rights will create the proper signals to attract the capital investment in renewables that is currently not being invested in this state. We are advancing that policy position before the appropriate entities: CPUC, CAISO and Federal Energy Regulatory Commission (FERC). Until that occurs, bilateral contracts are essential to provide the basis for investment.

(2) The prospect of bilateral contracts at or below the MPR may or may not be attractive depending on the energy market conditions at the time of the bid.

The MPR can be attractive as the basis of a "feed-in" renewable tariff as long as it is known prior to the bid and reflects a reasonable forecast of long-term price of energy and capacity. By default, in the RPS, the MPR has served functionally as a ceiling on prices. However, renewable development to date has not been robust under this scenario. If a tariff structure is developed in California, then it should recognize and unbundle the cost of energy from the value of "renewableness" attributed through a mechanism such as Tradeable Renewable Energy Credits (REC).

In the near term, FPLE believes that bilateral contracts are the appropriate mechanism to create the incentive for new renewable energy facility investment in California. Current policy has all RPS contracts being negotiated as the result of competitive bid solicitations by the investor-owned utilities. The Request for Offer (RFO) processes are conducted pursuant to statutory and regulatory protocols that have been developed at both the CPUC and this Commission. Presumably, the RFO yields bids that are priced to develop projects that meet a "least-cost, best fit" criterion as established by the CPUC. The level of the MPR is not known at the time of the bid. So bidders should be motivated to bid a price that reflects the amount of funding necessary to build a project. Furthermore, the MPR defines what the utilities recover in rates but Supplemental Energy Payments (SEP) are available in the event the cost of a project exceeds the MPR.[4]

However, the ability to receive SEPs has been restricted due to the bidder accepting the risk of either not receiving the SEP funds or the regulatory risk of the SEP allowance being rescinded. As discussed by others in this proceeding, since the SEP source is also the ratepayers, in the form of the public goods charges, it is important to remove this risk to allow bidders to submit a pricing level that reflects actual costs in a manner that leads

[4] Both the Green Power Institute and Alliance for Retail Markets have described the issues regarding the SEP/MPR interaction and have recommended possible policy changes. FPLE supports simplifying the SEP/MPR process as well and will not repeat those positions in this letter.

to financeable contracts either through escrow accounts or other encumbered income streams.

FPLE understands that the MPR provides a benchmark of pricing as a proxy for a fossil plant but if there is a policy intention to allow SEPs to support renewable development then they should be available without risk.

Nonetheless, tradeable RECs are a more attractive than the current structure. As stated in the 2005 IEPR[5] issued by this Commission, there is "too little transparency, too much complexity".[6] With unbundling the energy and the REC, the process of identifying the cost for new renewables would be both transparent and straightforward.

(3) Allowing for tradeable RECs and mitigating certain bidding process risks will help remove some of the impediments to FPLE bidding into California's renewable RFO process.

a. Development of a Tradeable REC market is essential. As stated above, separation of the environmental attributes from the energy price will expand the options available to developers of renewables. The CPUC has prepared a Staff White Paper[7] which details the attributes and benefits of tradeable RECs. FPLE concurs with the determinations of the Commission in the 2005 IEPR supporting the use of tradeable RECs.[8] Associated with the REC market should be a penalty for non-compliance by the utility in the event the RPS targets are not met. Such a penalty serves as a ceiling on the value of the REC and protects ratepayers from unreasonable renewable rate impacts.

b. Streamline bid review or make accommodations for timing. The bid review process - including such factors as screening criteria/prequalification criteria (such as the extent to which any permits have been obtained), bid evaluation criteria (including relative weighting of price and non-price factors) and evaluation timing and permitting timing uncertainty - are fundamental to many companies in a decision whether or not to participate in a particular bid process. The longer it takes to review a bid, select the winner and negotiate a contract, the more the initial bid does not reflect the market conditions into which it delivers. As a result, the developer is left with pricing which may not cover the costs to construct. We suggest that, for all future bidding processes, for just cause, an established escalator be allowed in price bids to reflect changes in general market prices for turbines and changes in local construction price indices in the event that the initial bid schedule for project selection and contracting is not met by the utility within a reasonable amount of time.

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[5] California Energy Commission, 2005 Integrated Energy Policy Report, CEC-100-2005-007-CMF, November, 2005 (IEPR)

[6] 2005 IEPR, p. 108

[7] California Public Utilities Commission, Renewable Energy Certificates And The California Renewables Portfolio Standard Program: Staff White Paper, Division of Strategic Planning; April 19, 2006

[8] 2005 IEPR, pp. 113-114

c. Remove burdensome performance and credit risk guarantees. Developing projects in California takes longer, and is subject to greater regulatory risk, than in most other states. This is mostly due to a lengthy permitting process that is entirely outside of the authority of the Commission. The addition of PPA performance guarantees requires, at a minimum, a bid price adjustment to compensate for this additional regulatory cost and risk. In addition, wind turbine and balance-of-plant costs in the last few years have been subject to extreme volatility in annual price increases such that it is simply not possible to know what capital costs are going to be until soon before construction commences. Given the uncertainty in timing of completion of permitting in California, it is simply not possible to economically hedge project costs, in the absence of a bidding process that allows for PPA price adjustments for changes in market prices for turbines and changes in local construction price indices. For an experienced developer of financeable power projects, this combination of factors -- permitting timing uncertainty and capital costs volatility - - are reason enough to forgo certain bidding opportunities.

Developers understand that California has a substantial and growing appetite for renewable energy and that it is likely that a successful project will be able to obtain a contract, once it has its permit, if the bidding rules create a level playing field. Developers also understand that, once the key permits are obtained, construction would be likely to begin within the next year or two and capital costs can be contractually established at the time of permit issuance. If bids are submitted by fully permitted projects, the risk that a project would be bid at a price that would be uneconomic by the time of construction would be removed. At present, since bids are to be submitted by entities regardless of permitting status, and since utility RFO processes require bidder acceptance of performance guarantees at a time of maximum permitting and capital cost uncertainty, there is a dilemma for experienced developers such as FPLE They can bid fully permitted projects that are certain to be constructed -- and financed -- at the bid price, but they must compete against projects that are not permitted, have no equipment and construction price and permitting timing certainty, and can only offer a price based on best guesses of what might be the ultimate project cost and timing. Under the circumstances, the decision of FPLE not to bid into California RFO solicitations is understandable. From a public policy standpoint, FPLE assumes that the state would rather see megawatts produced by renewable energy projects that are built at their proposed price, rather than simply have utilities collect on performance guarantees from cancelled projects. While FPLE is continuing to develop wind projects in California, FPLE continuously evaluates whether it is prepared to take the risk of bidding into RFOs under the current rules.

d. SEP eligibility without risk. The SEP program should be reformed to provide that SEP payments are made to the utility signing the contract for purchase of qualifying renewable energy. Evaluation of the appropriateness of the contract pricing provisions can then be done in one Commission proceeding, with an eye on the MPR The generator signing a contract for the sale of renewable energy to a utility in California should not be put in the position of taking the risks associated with the SEP program (see (2), above), which may result in a decision not to bid at all.

e. Support focused utility processing of transmission interconnection request and determination of deliverability. These are matters of great significance to many companies since they relate to PPA delivery deadlines as well as capital and operating costs. Without a complete understanding of the timing (and costs) of interconnection and transmission, developers cannot prepare accurate bids. As stated in Mr. Mark Bruce's presentation at the workshop, Texas is taking the initiative to establish renewable transmission zones.

f. Defined risk for environmental permitting. The wind/avian guideline development process is an example of actions taken by this Commission to provide greater certainty for developers as part of the permitting process in California.

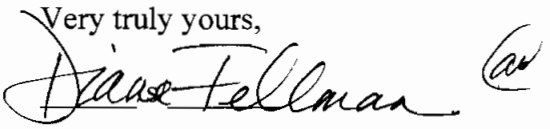
* * * *

While other stakeholders may have different perspectives, the matters discussed in this letter are critical to FPLE, a company dedicated to building new wind projects in California and throughout the United States. We would be happy to provide more detail, should the Commission require further information.

As stated earlier, FPLE is committed to support the efforts of this Commission (and other regulatory agencies) to create a positive environment to encourage investment in new renewable energy projects in California. With a few key modifications to its current RPS program, California can continue to be a leader in installed renewable energy projects based on a bold and innovative regulatory vision and the commitment of companies like FPLE to support the necessary regulatory reforms.

Thank you for the opportunity to provide this information. Again, do not hesitate to contact FPL Energy.

Very truly yours,



Diane I. Fellman
Director, Regulatory Affairs

cc: Honorable Jackalyne Pfannenstiel
Chair, California Energy Commission