

FLAT ROCK WINDPOWER LLC

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New York State
Public Service Commission
Case 03-E-1088

Proceeding on Motion of the
Commission Regarding a Retail
Renewable Portfolio Standard

COMMENTS OF FLAT ROCK WIND POWER, LLC

In these comments Flat Rock Wind Power, LLC (Flat Rock) responds to the Public Service Commission's (PSC) SAPA Notice (03-E-1088SA3, November 10, 2004) in Case 03-E-0188. In this notice the PSC advised that it was asking for comments on its consideration of "certification processes and procurement models for Main Tier resources that are most suitable under the specific market conditions created by the one-year extension of the federal Renewable Energy Production Tax Credit...."

Flat Rock's comments address only the near-term RPS procurement options identified in SAPA Notice 03-E-1088SA3. Flat Rock will submit separate comments in a future communication on the separate SAPA Notice issued in this proceeding (03-E-1088SA2, also issued November 10, 2004) concerning the broader implementation plan for the RPS.

Flat Rock supports the use of an expedited procurement (with contract award within the first four weeks of 2005) because this approach will reduce the cost of the

RPS, facilitate achieving the RPS goals for 2006 and beyond, and will accelerate economic benefits from the RPS to local communities. We also recognize that care must be taken in this initial round to "get the procurement details right." An incorrectly designed procurement could result in no bidders, unqualified bidders who cannot deliver MWs in the ground in 2006, or a windfall for developers at the other extreme. Consequently, developing appropriate design details will be a critical challenge in the limited time available for decision-making on the initial RPS procurement.¹

A. An expedited procurement policy will benefit the RPS in New York because it will lower the cost of the RPS in the initial years, enhance prospects for meeting initial RPS goals and accelerate economic benefits to local communities

1) Expediting procurement will lower RPS costs by taking advantage of the federal Production Tax Credit (PTC)

The key reason for expediting RPS procurement is to facilitate construction of projects, such as the Flat Rock wind farm and other eligible technologies, in 2005 in order to take advantage of the PTC. To encourage potential RPS participating technologies to obtain PTC benefits will significantly lower RPS costs.

The current PTC expires on December 31, 2005. Any wind energy projects wishing to use the PTC must be in commercial operation on or before this day. Unfortunately the PTC, which had expired at the end of 2003, was not reauthorized until September 2004. Further, there can be no certainty that the PTC will be extended beyond 2005. The Congress's late and limited extension of the PTC has given regulators, such as

¹ These comments offer a number of suggestions widely applicable to RPS procurement. Some of the comments, however, pertain solely to wind energy, as Flat Rock is a wind energy facility; these comments may not apply to other RPS-eligible technologies.

the PSC, and eligible industries little time to mobilize in order to take advantage of this narrow window of opportunity.

Facilities that qualify for the PTC (i.e. those that are constructed and commercially operating by December 31, 2005) will obtain a federal tax credit of approximately \$18 per MWh (escalating with CPI) for the first ten years of operation. In the case of Flat Rock, this means that if an accelerated RPS procurement facilitates construction of the site in 2005, the tax credit would result in over \$150 million in RPS savings over the life of the project. We anticipate that other PTC qualifying wind facilities would realize proportionate RPS savings as well.

2) Expediting procurement will enhance prospects for meeting RPS goals.

Expediting procurement is necessary to meet two RPS goals: lowering costs, discussed above, and putting renewable MWs in the ground in New York (the RPS calls for 1,360,424 MWh in year 2006 [approximately one half of which is expected from wind]).

As noted above, a key cost-cutting mechanism, PTC eligibility, requires that facilities be built and operating by year's end 2005. This construction timeframe will help achieve the RPS megawatthour goal for 2006. Furthermore, expediting procurement can reduce RPS costs by allowing developers to lock-in prices for wind farm hardware. If RPS policies are to play a role in meeting this construction deadline and lowering costs, procurement must take place in the first four weeks of 2005. In the specific case of Flat Rock, we have already seen our 2005 project size reduced from 300 MW to a currently projected 230 MW (assuming a January schedule is met) because of our

inability to make turbine commitments in the current market until the RPS procurement process has been completed.

This January deadline is driven by the practical realities of material purchase and construction timing in the wind industry. Expedited RPS procurement is necessary to provide the financial certainty needed to support contracting for wind farm hardware such as wind turbines, transformers and breakers, conduit and transmission towers. These acquisitions represent over 75 % of the cost of a wind farm.

As a result of the demand created by the PTC and other factors (e.g. declining dollar value vis-à-vis the Euro) there is fierce competition for these increasingly limited supplies of wind turbines and other equipment, and prices are escalating on a weekly basis. The result is that in order to assure supply and lock-in prices for 2005 construction, many developers will have to make major, irreversible capital expenditures for wind farm components very early in 2005. If RPS policy is to encourage companies to make these significant financial commitments that will facilitate the above-described cost savings and RPS compliance goals, a binding RPS procurement decision must be in place within the first four weeks of 2005.

3. Early procurement will accelerate benefits to local communities.

The Flat Rock project was initiated in 1999 and has been under active development in its current 300 MW configuration since 2002. Land leases have been signed with more than 100 landowners, with some of these leases now over five years old. The local community is anxiously awaiting the significant economic benefits the project will supply. For example, landowners will receive annual royalties in excess of one million dollars annually, local schools and municipalities will receive annual PILOT

payments in excess of eight million dollars, and a number of highly skilled jobs will be created to administer, operate and maintain the project. The project design, the system reliability study and interconnection agreement, and the project impact assessment have all been developed based on the participation and support of the local community and these selected landowners. The project sponsors consider it essential that at least the first phase of the project commence construction in 2005 to ensure the continued interest and support of the local community and the timely use of the permits that the project now holds.

B. Procurement must be carefully designed. It must encourage only credible facilities to participate; it must have fair contract terms that provide a basis for financing; and it must include protections against paying overly high prices.

1. A facility bond/Letter of Credit should be required to ensure that only credible facilities participate in the procurement process.

The PSC and NYSERDA should impose a Letter of Credit or bond requirement on projects participating in the procurement process. This bond/Letter of Credit should be submitted with the facility's bid. This requirement will help ensure that only projects with every expectation of successful construction and operation will be bid into the expedited process. Flat Rock suggests \$2,500 per MW of installed capacity would be appropriate (the same bonding amount was imposed by the Pennsylvania Sustainable Development Fund in an Oct. 10, 2002 wind energy solicitation). This level would be high enough so that it would discourage bids from developers that are not likely to proceed with development in 2005, but it should not discourage bids from credible developers that may not be as highly capitalized as other participants.

2. Procurement Approach

Flat Rock supports all three procurement options listed by the PSC SAPA Notice (auction, RFP and Standard Offer). Flat Rock is in a position to offer its energy bundled with the green attribute (or REC – renewable energy credit), or to offer the attributes to NYSERDA and market the energy separately.

The most important criteria from a wind energy developer’s perspective are that the procurement process be initiated in 2004, include only qualified and credible bidders and be concluded with signed contracts with certified projects on or prior to January 31, 2005.

3. Bid review must provide mechanisms to ensure that NYSERDA pays a fair price.

We recognize that this is an initial procurement, and it is critical that this initial step should have credibility with the public, the industry and participants. A significant component of success of the program is whether it results in a fair price for the attributes or RECs²...a price that encourages growth of the industry but does not result in a windfall for developers. Consequently, whatever procurement method is chosen for the initial round should contain a review mechanism to ensure that NYSERDA pays a fair price for these attributes or RECs. We defer to the PSC and NYSERDA in determining the mechanism, but offer the following observations:

² The payment made by NYSERDA will be for the public benefits or “green attributes” of the renewable energy. These attributes are often called Renewable Energy Credits or RECs and in many jurisdictions can be tracked as they are bought and sold as a commodity separate from the energy with which they were produced. We leave it to the PSC and NYSERDA to determine the most appropriate terminology to use in New York’s program; the term REC used here is illustrative only. However, contract language used in the RPS program should acknowledge a transfer of property rights for these attributes in order to prevent “double-counting” – i.e. subsequent sale of of such attributes outside of the RPS.

-- if a standard offer is the chosen procurement method, the price may be based on the recommendation of experts and could take into account the recent increases in the cost of wind power (e.g., due to a 25% decrease in the value of the US dollar versus the Euro over the last two years and recent price increases in steel and cement, etc.) and the green attributes/REC values in other areas, although these vary significantly.

-- if the auction option is chosen, the transparent competition between a sufficient number of multiple bidders should serve the requisite purpose.

-- if an RFP format is the procurement mechanism, we recommend that acceptance of qualified proposals should be based on as few and as transparent criteria as possible (preferably price alone).

4. The procurement contract must be fair and provide a basis for financing.

The key reason for accelerated procurement is to provide a contract commitment in early 2005 that establishes a future income stream (through the purchase of RECs) that is acceptable to sources of project financing. Unless the procurement contract can be used as a basis for financing, it will not provide the hoped for RPS incentive, and it is unlikely that many projects will be bid into, or be built on account of, this initial RPS solicitation. Consequently, if this initial, accelerated procurement is to be effective in securing the benefits outlined above, the contract details must not be a barrier to project financing.

Flat Rock has explored the contract details necessary for financing and offers the terms below as what should be included in the procurement contract. We suggest that it might also be useful to put a proposed contract on an agency web site and to accept comments. This would help expeditiously identify any "shows stoppers," i.e. unintended

contract provisions that could foreclose bids or RPS participation by credible participants. Early disclosure of the procurement contract will also help bidders understand exactly what they are bidding for and should therefore improve bid quality. The suggested terms are:

- a. Simplicity. The contract and bidding should be as simple and transparent as possible. There is limited time to develop an interim procurement approach and contract details. While more complex models/provisions might be considered for later offerings, we urge simplicity in bidding and contract documents for this procurement as the best approach for avoiding confusion or unintended consequences.
- b. Bid bond provisions. We discussed some bid bond parameters above. In addition to these the bond should provide that if the facility installs fewer MW than proposed in the bid there will be a pro rata call on the bond.
- c. Minimum contract term. The contract term must be for a minimum of 10 years. This is the minimum period necessary for project financing. Longer time frames could reduce costs. In any case, to ensure simplicity and uniformity of bids, all developers should be asked to present a price for the same term, be it ten years, twelve years, fifteen years or any other period chosen by NYSERDA.
- d. Single project bid/REC retirement. For purposes of simplicity, each project should provide only one bid. All rights to those attributes/RECs from a project that are bid into the RPS will be purchased and retired by NYSERDA.

The contract should make clear that after expiration of the contract period the facility is free to sell its attributes/RECs to other parties.

- e. Price. Prices should probably be bid and selected based on a flat rate. While future procurements may explore the benefits of bids containing fixed or variable escalating or declining rates, for this initial procurement a flat rate bid will probably be the most transparent and easiest to evaluate.
- f. Payment amount. The developer's bid should be for a set dollar amount per MWh for an estimated number of MWh per year (Estimated Annual Energy Production - EAEP) or a fraction thereof if only a portion of the facility's output is bid into the RPS procurement. The contract should provide payment for only the actual amount of MWh that the facility produces (or fraction thereof). There should be no penalty if the facility does not meet its EAEP, or if it exceeds its EAEP. This provision is needed because due to the unique nature of the NY RPS, there is no market for RECs to use to adjust to a specifically defined contract amount. In other words, the project cannot buy RECs in order to keep their commitment to NYSERDA when the project itself under produces, nor can the project sell RECs from overproduction to other purchasers. Such a provision is particularly important for a project where the total annual energy production is not completely predictable due to the annual variation in the natural resource, as is the case with many renewable energy resources including wind. Therefore the contract should be defined in terms of a goal and NYSERDA should commit to purchase the project output whether this is over or under the goal.

- g. Invoicing. Invoicing and payment will probably have to be coordinated with NYISO verification and payment protocols.
- h. NYSERDA's credit rating and guarantee. The credit rating of NYSERDA needs to be Baa3 (Moody's) or BBB- (S&P) or higher. If NYSERDA's credit rating falls below this standard, the contract should provide that NYSERDA will post an additional two years of revenue as security for the contract.
- i. Default. The contract must provide terms to address the event of default, including payment defaults, guarantee defaults and bankruptcy/receivership.
- j. Dispute resolution. The contract should provide for a dispute resolution process that includes negotiation and nonbinding mediation as required initial steps. Subsequent to these steps the contract should provide that disputes could be resolved by court proceeding governed by New York law and that each party waives the right to jury trial.
- k. Assignment. The contract should provide that it is assignable by either party upon written consent of the other party (which consent will not be unreasonably withheld).
- l. Financing liens. The contract must provide that the developer may grant a security interest in the contract without approval of the NYSERDA. This is a critical provision for obtaining project financing based on the contract.
- m. Trade secret. The contract must provide for appropriate protection under FOIL for commercially sensitive and trade secret materials

The above comments address Flat Rock's major contract concerns. We expect that there would be minor additional comments if a contract containing these provisions were posted for more detailed consideration prior to procurement bidding.

C. Conclusion

Flat Rock strongly supports an expedited procurement process. If properly designed this accelerated process will lower the overall costs of the RPS and be a major contribution toward meeting the RPS target for 2006. We look forward to continuing to work with State regulators and other participants to bring about this important first step toward realizing New York's 25% RPS goal.

Respectfully Submitted,

Flat Rock Wind Power, LLC

By: _____
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November 30, 2004
Albany, New York