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Via E-mail

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Re: Renewable Energy Coalition Comments
Legislative Concepts for 25-year Contracts for PURPA QFs – LC SQF1 – LC SQF2

The Renewable Energy Coalition ("REC") appreciates the opportunity to submit comments to the Energy and Telecommunications Interim Committee regarding the draft legislation pertaining to contract length for qualifying facilities ("QFs") under the Public Utility Regulatory Policy Act of 1978 ("PURPA"). REC supports long term contracts because they enable QFs to obtain financing for their projects and interconnections, are more consistent with utility integrated resource planning horizon, provide greater certainty for operations, and would allow comparable treatment between QFs and utility resources, which are included in rates for their economic life.

The three most important facts to ensure that non-utility owned independent power producers like QFs can construct projects are: 1) the length of the power purchase agreement; 2) the reasonableness of contract provisions; and 3) the avoided cost price that the utility will purchase power at. Without fair prices, length and contract provisions, otherwise economic new and existing generators will not be able to operate. REC notes that avoided cost prices in Montana are currently below actual avoided costs, and for PURPA to be properly implemented in Montana, it will be necessary to ensure more reasonable prices, regardless of the contract length. Long-term contracts at unreasonably low rates will not allow QFs to obtain financing either.

While the purpose of these comments is to explain the value of long-term contracts, REC objects to the unrelated provision in LCSQF1 Section that limits the Montana Public Service Commission (the "Commission") from imposing cost recovery constraints or shortened depreciation for the purposes of implementing PURPA. The Commission's policies limiting utility cost recover have created greater parity between utility and non-utility owned resources. The Legislature should not upset this balance without adopting other changes in regulatory policy, such as improved avoided cost pricing for QFs, limiting utilities ability to own new generation, and/or requiring utilities to procure all new generation through a truly competitive process.

1. The Renewable Energy Coalition Represents the Interests QFs

REC was established in 2009 and is comprised of over 30 members who own and operate over 50 QFs in Oregon, Idaho, Montana, Washington, Utah, and Wyoming. REC's membership includes irrigation districts, waste management districts, water districts, electric cooperatives, corporations, and individuals. Most QFs are small hydroelectric projects, but the membership also includes biomass, geothermal, solid waste, and solar projects. Because of its regional focus, REC provides a unique perspective for Montana to consider. REC has participated in and is currently participating in regulatory proceedings throughout the West regarding contract lengths and other PUPRA-related issues. REC strives for clear policies that maintain existing QFs and encourage the development of new QFs consistent with the goals of PURPA.

2. Long-Term Contracts are Important for QFs to Obtain Financing

QFs are unable to obtain project financing under short term contracts because lenders are unwilling to accept the uncertainty that accompanies those short term contracts. While sometimes not as critical, existing and operating projects often require long term agreements to fund system improvements and interconnection upgrades. Longer contracts, on the other hand, offer greater certainty and predictability, therefore making QFs more likely to obtain project financing. Specifically:

> [L]enders are generally unwilling to lend against uncontracted cash flows. This is especially true for smaller transactions projects (below about 50 MW), that are not of sufficient scale to attract larger, more sophisticated investors who may be willing to accept a few years of merchant or avoided cost exposure if certain underwriting protections are in place. Many in the industry actually consider the original standard offer contract length of 15 years to be insufficiently long compared to average utility contract tenors of 20 or 25 years. 10-year PPA tenors will lead to 10-year amortization periods, which will mean less debt and greater sponsor equity requirements at lower returns and greater risk. This in turn will result in many fewer projects getting financed and constructed. . . Limiting contracts to 10 years would have a two-fold impact. First, by reducing the amount of debt available to finance the project, it would increase the amount of equity required and thereby reduce the rate of return on that equity investment. Second, due to a larger percentage of the project's cash flows being uncontracted and inherently riskier, the projected rate of return required to attract equity investments would be significantly higher. These two dynamics in conjunction would make it significantly more difficult if not impossible to attract the required level of equity investment.[1]

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[1] Biennial Determination of Avoided Cost Rates for Electric Utility Purchases from QFs – 2016, North Carolina Utilities Commission Docket No. E-100 Sub 148, Direct Testimony of Patrick McConnell at 5-6 (Mar. 28, 2017).

Additionally:

> [i]n nearly all cases of which [the witness was] aware, project financing of QF projects has involved PPAs with much longer terms [than three years], typically twenty years." [The witness] represented that "[i]n [his] opinion and experience, a three-year PPA term would almost certainly prevent project financing for almost any new renewable energy project" and "[a]lmost any term length of less than twenty years would make project financing of renewable energy projects very difficult." [The witness] testified…that in an environment of higher avoided cost rates, a shorter contract length would be financeable but represented the rates "would need to be significantly higher in order to meet a three-year or a five-year contract term.[2]

As these excerpts illustrate, the length of the contract term is one factor that affects QF financing: longer contracts make it more likely that projects will be financed. These excerpts and more can be found in the enclosed review of project financing prepared by REC for the Washington Utilities and Transportation Commission in connection with its recent PURPA rulemaking proceeding.[3]

3. Long-Term Contracts Provide Other Critical Benefits

Long-term contracts can be necessary to operate and construct QFs, in addition to financing considerations. Unlike utility owned resources that are included in rates for their useful lives, QFs cannot enter into contracts for their entire economic lives. Thus, longer contract terms are appropriate to ensure that QFs are comparably treated with utility resources.

The certainty provided by long-term contracts also makes it easier for QFs to weather periods of low prices. Often the utilities' avoided cost prices offered to QFs have low prices in the early years and higher prices in the later years. Sometimes the only way to ever be paid the higher prices and make a project economic is to be able to sell power over a longer term.

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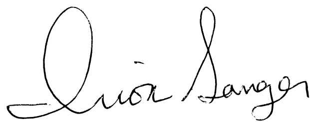
[2] Re Application of Rocky Mountain Power for Modification of Contract Term of PURPA Power Purchase Agreements with QFs, Public Service Commission of Utah Docket No. 15-035-53, Final Order at 9 (Jan. 7, 2016).

[3] While the enclosed review pertains mostly to project financing, it also contains detailed information on how contract length relates to project financing. Prepared in connection with: Re Rulemaking for Integrated Resource Planning, Washington Utilities and Transportation Commission Docket No. U-161024.

4. The Montana Legislature Should Enact Legislation Mandating Long-term Contracts

PURPA's goals are to encourage small power production by non-utility generators. In order to implement this goal, it is essential for Montana to develop and maintain clear policies that make it possible for QFs to obtain and keep project financing. Montana can do this, in part, by requiring longer term contracts.

Sincerely,


Irion A. Sanger

Marie P. Barlow

enclosure
cc: John Lowe
Renewable Energy Coalition
Founder & Executive Director