CIRI

March 18, 2010

The Honorable Lesil McGuire
Alaska State Senate
Alaska State Capitol, Room 125
Juneau, Alaska 99801

Dear Senator McGuire:

I appreciate the opportunity to respond to the criticisms and concerns raised in its letter dated March 8, 2010, by the Alaska Power Authority (APA) regarding Senate Bill 277, on behalf of Cook Inlet Region, Inc. (CIRI) as a potential independent power producer (IPP). While I will respond in a point-by-point fashion I will start with a higher level response that the APA's criticisms are generally a misunderstanding of the relationship between IPPs and their regulated public utility customers.

The APA fundamentally misunderstands the respective roles of an IPP and its utility customers, and the resulting relationship. Unlike a regulated public utility that has a certificated, monopoly service area granted by the Regulatory Commission of Alaska (RCA), an IPP has only wholesale customers obtained by arms-length commercial negotiations. The resulting differences are profound.

The essence of the issue is that Alaska has very few for-profit entities involved in the development and operation of electric power projects, and even fewer IPPs. The emergence of IPPs developing renewable energy projects has raised the possibility of a different model of developing projects in Alaska. Most of the comments in the APA's letter either result from a misunderstanding of the relationship between IPPs and their public utility customers or reflect an apparent mistrust of anything that is not a cooperative or municipally-owned public utility. We believe that the exemption proposed by SB 277 encourages and supports negotiated and commercially-reasonable relationships between IPPs and public utilities, and, as such, is good public policy.

I will now address the specific, numbered concerns raised in the APA's letter.

General Concerns

1. The exemption proposed by SB 277 is necessary.

   Obtaining a Qualified Facility designation under federal law does not simply provide an exemption from state regulation. A QF designation also provides the IPP with a default option of putting power onto public utilities in a non-consensual

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manner by selling to the utilities at avoided cost. CIRI does not believe that it would be appropriate or desirable to enter a market as small as Alaska's Railbelt in a non-consensual manner, even if it is possible under federal law. Moreover, the promise of renewable energy is to decouple the cost of power from the cost of fuel over time ultimately making renewable power cheaper than its fuel-fired alternative. Selling renewable power at avoided cost does not pass this promise on to the ultimate ratepayer. Perversely, selling renewable power at avoided cost allows an IPP to keep that benefit as profit, something you would think the APA would not suggest as its preferred public policy.

The option of applying to the RCA for a regulatory exemption is also an undesirable and impractical option for several reasons. The RCA has shown itself to be a slow, expensive and unpredictable regulatory body. Unlike public utilities who can recover the expense of their RCA practice in their respective rate bases and who have a state-sponsored monopoly against which to pursue project development, IPPs often have limited market windows in which to put together all of the necessary pieces to successfully develop private power projects, including successful negotiation of one or more power purchase agreements. The uncertainty, delay and expense of asking for a project exemption from the RCA layers an additional and significant project risk on private project development.

More importantly and fundamentally, however, the RCA has shown itself to be a partial and biased forum in which to seek the exemption from regulation for a project sponsored by a private, for-profit project proponent. A sitting RCA commissioner has privately questioned CIRI's motives in supporting SB 277 and has surmised that CIRI's motivation is trying to obtain out-sized returns—implying that being a for-profit entity makes CIRI an untrustworthy project proponent. Similarly, staff for the RCA has publicly testified in a prior Senate committee hearing on SB 277 that exempting a private, for-profit project from direct regulatory oversight could never be in the public interest, or words to that effect. These recent public and private sentiments demonstrate that the RCA is a potentially biased body from which a fair and impartial hearing cannot be obtained by a private, for-profit project proponent.

For these reasons, neither the federal QF nor the state RCA processes provides a reasonable and acceptable manner in which to exempt a IPP-sponsored renewable energy project from RCA regulation.

2. The fact that the RCA cannot second-guess the results of a commercial, arms-length negotiation between an IPP and a public utility is precisely the reason the exemption proposed by SB 277 is necessary. It is the public utility's job to ensure that the contract's rates, terms and conditions of service are fair and commercially reasonable. And it is a role that the public utilities are capable of fulfilling. It is unnecessary and unfair for an IPP, who bears all of the project development risk, to

have to negotiate a commercial PPA with one or more utilities and then start over with a regulatory process in the RCA that can take up to 18 months to complete.

It is also inappropriate to suggest that the RCA, and thereby any other interested party because of the public nature of RCA proceedings, must have access to all documents and costs of a project in order to satisfy the public interest. Again, the role of validating costs and justifying returns is best handled in a commercial negotiation. The second guessing and potential gaming of comments and motives in the RCA process only serves to drive up delay, expense and risk after the conclusion of negotiations between the IPP and the public utilities.

3. The RCA is not a necessary forum in which to adjudicate disputes between an IPP and public utility. There are numerous alternative dispute resolution methods, such as mediation and arbitration, that can provide for timely and expert adjudication of disputes short of filing lawsuits in court.

4. The "obligation to serve" is inappropriate to apply to a IPP-sponsored project because it is a concept that derives from the monopoly service territory granted to public utilities. Suggesting that a private project should have an "obligation to serve" shows that the APA fundamentally does not understand the relationship between an IPP and its public utility customers.

   Taking the APA's suggestion that IPP-sponsored projects should have an obligation to serve at its literal face-value would mean that the project could not refuse to provide service to any inter-connected public utility. How would this work? Does this mean that the IPP would have an obligation to serve any interested public utility but would not have any contract negotiation mechanism to arrive at a workable relationship? Obviously, this would not work.

5. The financial fitness of an IPP is a matter that should be addressed by the purchasing public utility. If that utility does not believe that the IPP is sufficiently capable of developing and operating the project for any reason—financial, technical or operational—then that utility can refuse to purchase the project's power. Layering the RCA over the top of this process implies that the public utilities are incapable of protecting themselves through due diligence and contract negotiations. Moreover, the APA's reference to the "fit, willing and able" standard again misapplies the public utility, monopoly standard of operation to the IPP concept. The "fit, willing and able" standard applies to public utilities because of their state-granted monopoly service territories. Implicit under that standard is a public utility's capacity and competence to determine the fitness of and negotiate the commercial purchase of power generated by others, including IPPs. It is surprising that the APA would suggest that its own membership (comprised of public utilities) is incapable of performing one of the core competencies within their own respective certifications as public utilities.

The suggestion that the RCA provides additional comfort in a bankruptcy situation is a red herring. The bankruptcy statutes provide for the bankruptcy court and bankruptcy trustee to protect the public interest. To suggest otherwise is simply a scare tactic intended to illicit the fear of the lights going dark because of the financial insolvency of an IPP. This is not a realistic scenario. The APA's motives are further illustrated by the suggestion that developing a project in a subsidiary entity is inappropriate—"owner" is not a dirty word when it describes a subsidiary entity used to develop and own a project and to suggest otherwise is simply an indirect way to slander private, for-profit entities.

6. The APA's suggestion that the affected utilities must be able to comment on a PPA post-negotiation is precisely why the exemption proposed by SB 277 is necessary and appropriate. Allowing a utility that has negotiated a PPA to later come back through the regulatory process to renegotiate the contract suggests that bad-faith negotiations and gaming are an appropriate business practice. We do not agree. To suggest that other non-contracting utilities have some basis for reviewing and commenting on PPAs to which they are not a party is to invite the sort of regulatory busy-body filings that drive up the cost, delay and uncertainty of the RCA process.

Specific Concerns

1. The 65 megawatt size limit is not too large. The APA suggests that a 500 kilowatt limit is appropriate. While we agree that a .5 megawatt facility should be exempted, we believe that larger facilities should be exempted as well. IPPs need a predictable and fair process to negotiate for the commercial sales of their project power. Without predictability and fairness, the status quo—no IPPs on the Railbelt and no large commercial-scale renewable projects will likely persist.

2. The APA's suggestion that an IPP could cherry pick other non-electric utilities as customers is unrealistic. How would an IPP deliver the power to its non-electric utility customer without negotiating a transmission agreement with the existing electric utility? And how would the IPP deliver firm power (as opposed to the intermittent power produced by renewable power sources) without negotiating a firming agreement with the electric utility? These points illustrate the APA's principal concern: competition. CIRI believes that the discipline, efficiency and market competition demanded of IPPs, as for-profit enterprises, bring benefits to the cost of power and ultimately to the ratepayer. The APA obviously disagrees and prefers non-competitive, government-sponsored monopolies.

3. The APA again raises the "obligation to serve" notion addressed above. I will not address it again.

4. This point is a permutation of the "obligation to serve" point again. But it also raises for the first time the possibility of an IPP owning a regulated entity. The RCA already possesses the ability to look through ownership structures to sister and parent companies of regulated utilities. Thus, the RCA already possesses the authority and tools to address this potential issue.

5. This point highlights an APA inconsistency. In the General Concerns point number one, the APA suggests that an IPP can get certified as a Qualified Facility under federal law in arguing that SB 277 is unnecessary. In this point, it decries the "contentious experiences" of utilities who had to deal with developers who were attempting to force them to purchase power in a non-consensual manner—a veiled reference to the very QF program it suggests above as an available alternative. As stated above, we agree that non-consensual power sales are not in the ultimate interest of Alaska's public utilities. The exemption proposed by SB 277 fosters negotiated and consensual power sales between IPPs and incumbent utilities. This is exactly the point.

Sincerely,

Cook Inlet Region, Inc.

Ethan Schutt
Senior Vice President, Land and Energy Development