State of Rhode Island and Providence Plantations

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Peter F. Kilmartin, Attorney General

November 23, 2011

Luly Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

RE: **OFFICE OF ENERGY RESOURCES**
DISTRIBUTED GENERATION CEILING PRICES
DOCKET NO. 4288

Dear Luly,

Enclosed for filing with the Commission on behalf of the Division of Public Utilities and Carriers ("Division"), please find an original and nine (9) copies of the Division's Responses to the Commission's Second Set of Data Requests in the above entitled matter.

Very truly yours,

Jon Hagopian
Special Assistant Attorney General

JGH/mec

Encl.

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: R.I. OFFICE OF ENERGY RESOURCES'	:	
PROPOSED DISTRIBUTED GENERATION	:	**DOCKET 4288**
STANDARD CONTRACT, CLASSES AND	:	
CEILING PRICES	:	

RESPONSE OF THE DIVISION OF PUBLIC UTILITIES AND CARRIERS TO THE PUBLIC UTILITIES COMMISSION'S SECOND SET OF DATA REQUESTS

Commission Data Request 2-1

The Division consultants wrote on October 24, 2011 that the major assumptions underlying the ceiling prices are reasonable and referred to "installed (or capital) costs, operations and maintenance costs and capacity factors." According to the R.I.G.L. 39-26.2-5(a), ceiling prices for each technology should be a price that would allow a private owner to invest in a given project at a reasonable rate of return, based on recent reported and forecast information on the cost of capital, and the cost of generation equipment. The statute further provides,

> "The calculation of the reasonable rate of return for a project shall include where applicable any state or federal incentives including but not limited to tax incentives."

In Appendix D of OER's proposed ceiling prices, OER cites a target after-tax equity IRR of 13% for wind (1500KW), solar (150KW) and solar (500 KW). Does this 13% IRR constitute a reasonable rate of return, based on recent reported and forecast information on the cost of capital, and the cost of generation equipment, as required by R.I.G.L. 39-26.2-5(a)? Why/why not? Please include in your response whether there is a range of returns which the Division deems reasonable.

Division Response 2-1

La Capra Associates, Inc., acting as consultant to the Division, believes that ceiling prices calculated in this proceeding that are expected to yield an after-tax equity IRR of 13% do constitute a reasonable rate of return. In Docket No. 4111, Mr. Hahn testified that a typical IRR for a renewable project would range from 12% to 15%. (See the testimony of Richard S. Hahn dated February 2, 2011, page 14, lines 13 to 16.) The 13% IRR assumed by OER in this proceeding is within that range, and is reasonable given the risks associated with small wind and solar projects that received long-term fixed price contracts.

Prepared by: Richard Hahn & Alvara E. Periera
LaCapra Associates

Commission Data Request 2-2

How did OER calculate the 13% IRR cited in its September 27 filing? Please include in your response whether a range of returns was considered in developing the 13% IRR, and identify with specificity all data, tools, models, forecasts and other sources used to calculate same.

Division Response 2-2

It is La Capra Associates' understanding that the 13% IRR was not calculated by OER but was an input assumption used in the CREST model, along with capital costs, O&M costs and capacity factor. Via questionnaire, OER sought inputs for use with the CREST model, but La Capra Associates has not seen the results of those questionnaires and therefore does not know what information was provided regarding the appropriate IRR. To the best of our knowledge, OER did not consider a range of values for the targeted IRR. In most pro forma analyses, the targeted IRR is set subjectively at the level deemed necessary to entice developers to invest in such projects considering the risk level of the projects. As stated in response to Request 2-1, La Capra Associates believes that a 13% IRR is a reasonable return, based upon the risks borne by the project.

Prepared by: Richard Hahn & Alvara E. Periera
LaCapra Associates

Commission Data Request 2-3

Did OER's calculation of the rate of return, assumed in the CREST model, include any state or federal incentives?

Division Response 2-3

The OER calculations of the ceiling prices that would be expected to yield a 13% IRR included federal incentives, but excluded state incentives.

Prepared by: Richard Hahn & Alvara E. Periera
LaCapra Associates

Commission Data Request 2-4

In light of the Division's response to Commission DR 1-1 and 1-2, and in particular the Division's estimated downward rate impact of $319,540 in Year 1 with different modeling assumptions, does the Division believe that OER's proposed ceiling prices could be lower without circumventing the statutory requirement that the prices should allow the developer a reasonable rate of return?

Division Response 2-4

The reduction in annual payments of $319,540 is to due to three changes in modeling assumptions.

1. Assume that all federal and state tax incentives are utilized when generated (versus the OER assumption that not all such incentives will be utilized when generated).
2. Exclusion of assumed lease payments by third party developers to the owner of the host site (versus the OER assumption that all projects would incur a lease payment as a cost).
3. Inclusion of state grants (versus the OER assumption of no state grants)

The reductions due to items 1 and 3 above should be reflected in the ceiling prices for two reasons. As stated in Request 2-1, the statute states that the "calculation of the reasonable rate of return for a project shall include where applicable any state or federal incentives including but not limited to tax incentives." So the statute requires that such incentives be included in the ceiling prices. It should also be noted that the ceiling prices present an opportunity for the developer of eligible renewable energy projects to earn a reasonable rate of return. The ceiling prices are not a guarantee of any particular return. If project capital costs are higher than estimated by OER, then the actual return will be lower than 13%. If capital costs are lower than estimated by OER, the actual return will be higher than 13%. Similarly, not being able to take full advantage of all tax incentives will result in a different actual return, but the potential to reap those benefits exists. Potential uncertainties and risks are common in the development of energy projects, and that is why the target return of 13% is higher than a regulated rate of return. Therefore, it is appropriate to include the full potential value of these tax incentives in the ceiling prices, and such inclusion would not conflict with the statutory requirement to establish ceiling prices that present an opportunity to earn a reasonable rate of return.

Regarding the reduction to item 2 above, La Capra Associates notes that if lease payments are included in the ceiling prices and no lease payment is incurred, then the IRR will be higher than 13% all else being equal. Similarly, if lease payments are excluded from the ceiling prices and a lease payment is incurred, the IRR will be lower than 13%. One way to deal with this uncertainty would be to have two ceiling prices – one for third party developers (including the lease payment) and one for projects developed by the host customer (excluding the lease payment).

Another way to proceed would be to accept the ceiling prices as proposed by OER for the first year of this program only (i.e., 2012), assuming that no precedents are created for

future years. Given the relatively small impact on rates identified in the response to Request 2-5, the downside to this approach is low. After gaining experience with actual bids, the ceiling prices could be revisited for use in subsequent years.

Prepared by: Richard Hahn & Alvara E. Periera
LaCapra Associates

Commission Data Request 2-5
Referring to the Division's response to Commission DR 1-2, what would be the annual bill impact on an average residential, industrial and commercial customer, assuming the changes to the modeling assumptions were adopted in the CREST model, resulting in lower ceiling prices and reduced ratepayer costs of $ 319,540, as indicated in the Division's data response?

Division Response 2-5
The 2010 FERC Form 1 Report for Narragansett Electric Company and the November 1, 2011 settlement agreement in Docket No. 4295 yielded the following statistics.

- Annual retail sales are 7,795,659,066 KWH
- Average residential usage was 7,273 KWH per year or 606 KWH per month
- Average commercial and industrial usage was 45,522 KWH per year or 3,794 KWH per month
- One large TOU customers used 37,119,000 KWH per year or 3,093,250 KWH per month.

If annual payments to renewable projects were reduced by $319, 540, and this reduction was allocated on KWH usage, the reduction per KWH would be $0.000041 per KWH.

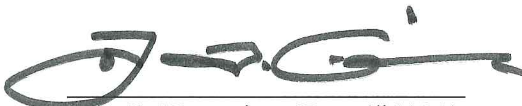
Based upon the above data, the reduction in average bills would be as follows.

- Residential monthly bill - $0.02
- Commercial / industrial month bill reduction - $0.15
- Large TOU month bill reduction - $126.79

It should be noted that National Grid is in a better position to quantify the bill impacts of this reduction.

Prepared by: Richard Hahn & Alvara E. Periera
LaCapra Associates

Thomas Ahern, Administrator
State of Rhode Island
Division of Public Utilities and Carriers
By his attorney,



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Dated: November 23, 2011

CERTIFICATION OF SERVICE

I hereby certify that on the 23rd day of November, 2011, I transmitted an electronic copy of the within Response to Data Requests to the attached service list and to Luly Massaro, Commission Clerk via electronic mail and regular mail.

Docket No. 4288 – Office of Energy Resources Filings: 1) Proposed Distributed Generation (DG) Standard Contract Act Classes and Ceiling Prices for 2011; and 2) Proposed DG Standard Contract
Service List updated 11/10/11

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