



**Illinois Commerce Commission  
Comments Concerning the Spring 2011 Electric Procurement Events  
Which Were Held On Behalf of  
Commonwealth Edison Company and Ameren Illinois Company**

**Respectfully Submitted by Iberdrola Renewables, Inc.  
June 22, 2011**

Introduction

Iberdrola Renewables, Inc. (“IRI”) is a renewable energy developer, owner, and operator headquartered in Portland, Oregon. The company also owns and operates natural gas storage in North America and thermal generation in Oregon. IRI owns and operates over 4,600 MWs of wind farms in seventeen states and is developing solar and biomass projects. One of the company’s Midwest development offices is located in Palatine, Illinois. IRI owns and operates two Illinois wind farms, Providence Heights (72 MWs) in Bureau County and Streator Cayuga Ridge South (300 MWs) in Livingston County. IRI has won contracts in each Illinois Power Agency (“IPA”) one-year renewable energy credit (“REC”) auction and also successfully won two long-term contracts for the New Harvest wind farm in Iowa.

We thank the Illinois Commerce Commission (“ICC”) for providing this opportunity to submit comments “Concerning the Spring 2011 Electric Procurement Events Which Were Held On Behalf of Commonwealth Edison Company and Ameren

Illinois Company.” IRI’s comments will focus on the REC auction component of the procurement for both utilities.

### Illinois Renewable Portfolio Standard Background

The Illinois Power Agency Act of 2007, which authorized the RPS, included the following legislative declaration and findings (among others):

- “Escalating prices for electricity in Illinois pose a serious threat to the economic well-being, health, and safety of the residents of and the commerce and industry of the state.”
- “To protect against this threat to economic well-being, health, and safety it is necessary to improve the process of procuring electricity to serve Illinois residents, to promote investment in energy efficiency and demand-response measures, and to support development of clean coal and renewable resources.”
- “Procuring a diverse electricity supply portfolio will reduce long-term direct and indirect costs to consumers by decreasing environmental impacts and by avoiding or delaying the need for new generation, transmission, and distribution infrastructure.”

The IPA was vested with a number of powers and responsibilities in order to achieve the statute’s goals, including to:

“Develop electricity procurement plans to ensure adequate, reliable, affordable, efficient, and environmentally sustainable electricity service at the lowest total cost over time, taking into account any benefits of price stability...”

The Illinois Renewable Portfolio Standard (“RPS”) calls for an increasing annual amount of renewable energy procurement to serve the state’s retail electricity customers.

The RPS requirement began in 2009 at two percent and increases annually such that renewable energy provides twenty-five percent of the state’s retail electricity by 2025.

This creates an increasing future demand for renewable energy which must be met by a commensurate increasing supply. Six percent of the requirement must be met by solar

energy. Seventy-five percent of the requirement must be achieved through wind energy for eligible customers and sixty percent must come from wind energy for alternative retail electricity supply (“ARES”) customers. The RPS cost is limited to the greater of 2.015% of the amount paid per kWh in 2007 or the incremental amount paid in 2011.<sup>1</sup> The IPA also sets individual price benchmarks that may not be exceeded. As a result, the interaction of the RPS’s escalating demand and fixed cost cap requires that an increasing amount of renewable energy be purchased over time at a declining cost.

In sum, the IPA is responsible for procuring an increasing amount of least cost renewable energy at a value under the cost cap and benchmarks while achieving some amount of price stability. As IRI has presented in other forums related to this matter, we believe that a complete reliance on one-year REC only procurements will not achieve all of these objectives and that a move to a “portfolio-based” approach which includes a mix of longer and medium-term REC procurements along with some short-term and spot-market purchases will best achieve the objectives of the Illinois Power Agency Act. Long-term bundled contracts for energy and RECs should also play a meaningful role in the IPA’s RPS procurement strategy.

#### Shortcomings of One-Year Renewable Energy Certificate (“REC”) Procurements

In order for any new electricity generation project to be economical (including a new renewable energy project) the revenue it receives over the long-term must be sufficient to recover the large initial capital investment, as well as any short-run operating and maintenance expenses. Historically, prior to the restructuring of the state’s retail

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<sup>1</sup> [www.dsireusa.org](http://www.dsireusa.org) “Illinois Renewable Portfolio Standard Summary.”

electricity market, electricity sector investments recovered both their capital and operating/maintenance costs through long-term guaranteed cost recovery mechanisms such as a Commission approved rate of return. (Such mechanisms are still in place for transmission and distribution). RPS markets in restructured states have primarily relied upon RECs as a principal cost recovery mechanism. Renewable energy developers, particularly companies like IRI which have invested heavily in wind energy, also rely on two other primary revenue streams: (1) wholesale energy of which wind energy is a price taker, and (2) federal tax incentives. (To a lesser extent wind energy projects in PJM are also capable of receiving capacity payments).

One of the fundamental purposes of RECs (in addition to its tracking mechanism function for RPS compliance) is to provide a revenue stream that allows a renewable energy investment to recover the difference, if any, in its total costs and the value of wholesale energy and federal tax incentives. We will refer to this as a renewable energy project's incremental costs. As such, RECs act as a key financial indicator as to whether a renewable energy project will be able to recover its total costs. In short, REC prices are often the difference between a project being economical or uneconomical. For example, if REC payments do not enable a renewable energy investor to recover its incremental costs then they will be unwilling to commit capital to future projects required to meet increasing RPS demand.

To date, the IPA has primarily relied upon one-year REC purchases in order to promote RPS compliance. We provide the following example to demonstrate the potential short-comings of this approach. Let us assume that a new renewable energy investment,

necessary to meet future Illinois RPS demand, requires a long-term REC price of \$20 to cover its incremental costs. For example purposes only, we will assume this REC price is needed for an eight-year term.<sup>2</sup> (We picked an eight-year term to make the example demonstration easier. In reality a longer term is preferred, with at least twenty years being an ideal term that encourages new investment). We will use actual IPA REC auction results for Com-Ed to demonstrate our view. The results of these one-year REC procurements, for an increasing amount of RECs each year, for wind in the Commonwealth Edison service territory were:

2008: \$35.72 (Illinois Wind); quantity: 734,735 (estimated)

2009: \$21.13 (Illinois Wind) quantity: 821,289 (estimated)

2010: \$5.00 (Illinois Wind); quantity: 1,507,642

2011: \$1.05 (Illinois or Adjacent State Wind); quantity: 1,587,791

These results led to an average weighted REC price of \$9.89. In our example, this average weighted REC price would not be sufficient to encourage new renewable energy development (or, in fact, to achieve revenue adequacy for existing renewable energy investments). Therefore, presuming rational market behavior on the part of renewable energy investors, in future years REC prices must rise to well above a new renewable energy project's long-term incremental costs. In our example, REC prices would need to

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<sup>2</sup> This price and term is for example purposes only and does not necessarily reflect an actual market requirement. There are many elements that must be factored to determine required price and term, including: long-term wholesale energy market prices, value of federal tax incentives, capital costs, balance of plant costs, borrowing costs, and costs and expenditures.

have a weighted average of \$30.11 over the next four years in order for the project example to recover its long-term costs.

The volatility of the prices produced by these procurements would also make it very difficult for renewable energy developers to receive bank financing for their projects in the future. Even developers which rely on balance sheet financing will be dissuaded from making investments given the unpredictable and volatile nature the one-year REC procurements have produced. In today's financial environment, investors are highly risk averse and will be unwilling or unable to finance projects that cannot demonstrate a long-term, fixed revenue stream from a reliable counterparty.

Thus, sole or primary reliance on one-year REC procurements is problematic in five ways: (1) it subjects rate-payers to potential significant amounts of price volatility (that has been apparent in the first four one-year REC auctions); (2) Unpredictable and volatile prices will make project finance very difficult if not impossible; (3) since the RPS requires increasing amounts of renewable energy with a flat renewable resources budget, higher prices in any single year could lead to a failure to meet individual year RPS requirements under the renewable resource budget; (4) volatile and higher REC prices for utility customers could encourage shifting to competitive suppliers which would add more instability and uncertainty to the RPS which would further discourage new renewable energy investment, and; (5) while this is subjective; we believe there is significant political risk to the RPS when prices are too high in any single year (even if on average they are consistent with a new renewable energy project's incremental costs).

Lastly, we observe that the REC prices produced in the one-year REC auctions are not necessarily reflective of a new renewable energy project's incremental costs. In fact, it is almost certain that REC prices produced in the 2010 and 2011 auctions do not remotely reflect a new renewable energy investment's incremental costs. Rather the one year REC auction results are the product of short-term supply and demand scarcity or surplus and are not necessarily reflective of average incremental costs. This short-term focus will tend to either overestimate those costs (2008) or underestimate them (2010 and 2011). The result has been volatility, and recently a significant downward trend that is producing prices which will not encourage new renewable energy investment.<sup>3</sup>

We believe that continued reliance on one-year REC auctions as the sole or primary means for RPS compliance will likely not only lead to the negative outcomes stated above, but will also strongly diminish new renewable energy investment required to meet the state's increasing renewable energy requirements, putting long-term RPS compliance in jeopardy. There is a more prudent way for the IPA to conduct RPS procurements that will generate REC prices more reflective of a new renewable energy project's long-term incremental costs while still promoting flexibility and liquidity.

#### Alternative to One-Year REC Procurements

An efficient and effective procurement process will produce a REC price that is reflective of the most cost-effective new renewable energy project's long-term incremental costs. One-year REC procurements could produce such a result over the long-term if prices were

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<sup>3</sup> We again reference the IPA's responsibility to promote price stability references on page 2 of this testimony.

allowed to rise high enough to achieve a long-term average price reflective of a project's long-term incremental costs. However, such high prices are essentially capped in two ways: (1) through the limitations of the renewable resources budget and; (2) we believe politically, since individual single-year high prices are unlikely to be acceptable (We recollect that there was some concern regarding the "high" prices produced in the 2008 auction, even though, just like the 2011 auction which produced an exceedingly low price, they were the result of short-term REC supply and demand imbalances). As a result, we believe that sole or primary reliance on one-year REC procurements will ultimately result in prices insufficient to meet a new renewable energy project's long-term incremental costs.

IRI has advocated in other forums that long-term bundled (energy and REC) contracts are the most efficient way to encourage new renewable energy investments, and are in keeping with the Illinois Power Agency Act of 2007 legislative declaration and findings. Assuming that such procurements are competitive, they should produce a price that is reflective of a new renewable energy project's incremental costs. This is because renewable energy investors, recognizing the competitive nature of the procurement, will be motivated to offer a price that is reflective of their total costs in order to give them the best chance to win the bid and because (assuming the contract terms are reasonable) a long-term contract hedges price risk for a meaningful portion of a project's lifetime revenue stream. We believe this outcome was reflected in the IPA's 2009 request for proposals for long-term bundled renewable energy contracts. This process resulted in an average weighted bundled price of \$53.65. These 20-year contracts locked in stable long-term pricing for rate-payers (one of the most valuable features of renewable energy) while

promoting near-term investments in new renewable energy development. We believe this type of procurement is completely consistent with the Illinois Power Agency Act's charge to the IPA to promote price stability.

To the extent that the IPA is not seeking to do long-term bundled procurements or to complement such procurements, we strongly encourage the Agency to consider a "portfolio approach" for future REC procurements. We recommend that the IPA seek REC strips of varying lengths: 10-year, 5-year, and 1-year in its 2012 procurement. In our view the longer-term strips will produce a REC price closer to long-term incremental costs. This will help provide important price stability, help to ensure that REC procurements stay within the renewable resource budget in the out-years and send a price signal to developers to invest in resources to meet future, increasing RPS demand.

The IPA could develop benchmark prices for the longer-term REC procurements and compare offers to those benchmarks to ensure that offers are consistent with the Agency's view of long-term incremental costs. This assures an additional layer of rate-payer protection, on top of the renewable resource budget.

## Conclusion

IRI thanks the ICC for the opportunity to present these comments. We would be pleased to provide additional information and/or to discuss them with stakeholders and the Commission in more detail. I may be contacted at 484-654-1887 or [ethumma@iberdrolaren.com](mailto:ethumma@iberdrolaren.com) .

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'ETH', is centered on the page.

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Institutional Relations