

**DOCKET**

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# **Lowering the Effective Cost of Capital for Generation Projects**

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**for**

**California Energy Commission**

**California Credit Policies  
Workshop**

**June 27, 2006**



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# IOU Bid Deposit Requirements

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- **PG&E**
  - \$3/kw of contract capacity
- **SCE**
  - \$25,000
  - Short List Deposit = the greater of \$ 0.00 or  $[(A \times B) - C]$   
(where A = Net Contract Capacity, B = \$3 per kW, C = \$25,000)
- **SDG&E**
  - \$3/kw of contract capacity not to exceed \$100,000

# Development Period Security Deposit

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- PG&E
  - \$20 per kW until Construction Start Date; \$36 per kW thereafter
- SCE
  - \$20 per kW
- SDG&E
  - \$5 x estimated annual production x 2

# PG&E Performance Assurance

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20 points	<p>(1) Security Deposit:</p> <p>a. Post-commercial operation date:</p> <ul style="list-style-type: none"> <li>• 10 yr contract: 6 mos. revenue</li> <li>• 15 yr contract: 9 mos. revenue</li> <li>• 20 yr contract: 12 mos. revenue</li> </ul> <p>(2) Credit Assurance</p> <p>(3) Replacement Cost Collateral</p>
10 points	<p>(1) Security Deposit:</p> <p>a. Development: \$20/kw;</p> <p>b. Post-commercial operation date:</p> <ul style="list-style-type: none"> <li>• 10 yr contract: 3 mos. revenue</li> <li>• 15 yr contract: 4½ mos. revenue</li> <li>• 20 yr contract: 6 mos. revenue</li> </ul>
0 points	No security

Pacific Gas and Electric Company, *Renewables Portfolio Standard, Solicitation Protocol, August 4, 2005 (Conformed with D.05-07-039).*

# SCE Performance Assurance

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- Amount: the mark-to-market value
  - plus any amounts owed or otherwise accrued and payable to SCE from Seller
  - less any amounts owed or otherwise accrued and payable to Seller by SCE
  - less the Seller's collateral threshold
  - less any performance assurance already posted.

Source: Southern California Edison, *2005 Request for Proposals from Eligible Renewable Energy Resource Suppliers for Electric Energy, Procurement Protocol Revision 1.*

# Security Requirements of Other Utilities

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- SDG&E
  - \$15 x estimated annual production x 2
- Nevada Power Company/Sierra Pacific Power Company
  - Average Annual Supply Amount multiplied by \$4.09
- Arizona Public Service Company
  - Subject to negotiation
- New Mexico Public Service Company
  - Collateral covering anticipated delivery obligations under a contract
- PacifiCorp
  - \$60 per kW

# Rationale for Strict Credit Requirements

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- Bid Evaluation Stage
  - To discourage weak proposals
- Development Stage
  - To cover potential penalties for failure to meet RPS requirements
  - To ensure that project achieves commercial operation (payment of Daily Delay Liquidated Damages)
- Commercial Operation Stage
  - To cover performance requirements
  - To cover default and termination damages



Ideally, the Merits of the Potential Risk  
Should Be Evaluated and a Value Should  
Be Placed on that Risk



# Bid Evaluation Stage

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- IOU deposit requirements are very high
  - Discourages bid participation
  - Less competition in solicitation process
- Mitigants
  - Least-Cost, Best-Fit
  - CPUC oversight
- Proposed alternatives
  - Reduction in bid deposit

# Development Stage

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- IOU Deposit Requirements are too high
  - Places strain on development budget (typically a cash payment)
  - Costs are passed through to ratepayers in form of higher contract price
- Mitigants = Reduction in Deposit Requirements
  - Good faith exemption from penalties under RPS
  - Construction Lender backstop
  - Major Equipment Warranties
- Proposed Alternative Security Structures
  - Step-in rights
  - Subordinated security interest
  - Direct assignment of % of Buydown under Turbine Warranty
  - Payment of Daily Delay Liquidated Damages

# RPS Penalties

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- 5 cents per kWh, subject to annual cap per utility of \$25 million
- good faith efforts exception (vague standard)

Sources: D. 03-06-071 (Jun. 19, 2003) and D.03-12-065 (Dec. 18, 2003)

# Commercial Operation Stage

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- IOU Security Requirements are among highest in US
  - Costs are passed through to ratepayers in form of higher contract price
- Mitigants = Reduction in Credit Requirements
  - IOU load reserve requirements
  - Lender backstop
  - Major Equipment Warranties
  - Insurance
- Proposed Alternative Security Structures
  - Step-in Rights
  - Subordinated security interest
  - Requirement that insurance proceeds be reinvested or buydown of contract capacity
  - Assignment of % of buydown under turbine warranty
  - Assignment of % of proceeds from Availability Guaranty

# Step-in Rights

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**In the event of a default under the PPA, Buyer could “step-in” and operate the Facility itself.**

- Subordinate to Senior Lender.
- Lenders will be concerned unless Buyer also assumes all of Seller’s obligations to the lenders under the loan agreement and other project documents.
- Potential for Buyer direct liability.
- Step-In Rights may also raise concerns over the creditworthiness of Buyer and liability or harm to the Facility during the step-in period.
- Time consuming and expensive
- Potential for conflict with O&M Agreement

# Subordinated Security Interest and Assignment of Warranty Payment

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- Subordinated security interest may have little or no value during early period of term (debt restrictions may increase value)
- Early period exposure covered by assignment of % of Warranty payments
- Warranty period is typically 5 years. After year 5, subordinated security interest is becoming more valuable.

# Role for the State

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- Clarification by CPUC of good faith exemption from RPS penalties
- Energy Commission should prepare a report with recommendations for future action
  - How should the credit risk be quantified
  - Balancing between ratepayer protection/higher rates
  - Additional risk mitigants
  - Risk pooling/risk reduction by State (e.g., Nevada)

