

Delaware Public Service Commission
Delaware Energy Office, Department of Natural Resources and Environmental Control
Delaware Office of Management and Budget
Delaware Controller General

COMMENTS TO THE MINERALS MANAGEMENT SERVICE'S PROPOSED RULE

Alternative Energy and Alternate Uses of Existing Facilities on the Outer Continental Shelf

Regulation Identifier Number (RIN) 1010-AD30

September 8, 2008

I. Introduction

The Delaware Public Service Commission (Commission), the Delaware Energy Office, Department of Natural Resources and Environmental Control (Energy Office), the Delaware Office of Management and Budget, and the Delaware Controller General (collectively, the Delaware Agencies) appreciate this opportunity to comment on the Proposed Rule for Alternative Energy and Alternate Uses of Existing Facilities on the Outer Continental Shelf (the Proposed Rule) issued by the Minerals Management Services (MMS) and published in the Federal Register on July 9, 2008. 73 Fed. Reg. 39,376.

The Delaware Agencies have played a historic role in pioneering the development of offshore wind energy facilities in the United States. Pursuant to Delaware State law,¹ the Delaware Agencies approved on September 2, 2008 a long-term power purchase agreement (PPA) between Delmarva Power & Light Company (Delmarva Power), the largest investor-owned electric utility in the state, and Bluewater Wind Delaware LLC (Bluewater Wind), the developer of a 200-600 MW wind energy facility in federal waters offshore of the coast of Delaware.² This represents the first commercial-scale power purchase agreement for electric power and renewable energy credits (RECs) from an offshore wind energy facility in the United States.³ The approval of this

¹ Electric Utility Retail Customer Supply Act of 2006, Section 6, replacing 26 Del. C. § 1007(d).

² Order No. 7440, In the Matter of Integrated Resource Planning for the Provision of Standard Offer Supply Service by Delmarva Power & Light Company Under 26 Del. C. § 1007(c)&(d): Review and Approval of the Request for Proposals for the Construction of New Generation Resources Under 26 Del. C. § 1007(d) (opened July 25, 2006), PSC Docket No. 06-241 (Sept. 2, 2008), (hereinafter, "Order No. 7440"), <http://dep.sc.delaware.gov/orders/7440.pdf>.

³ Under the power purchase agreement, Delmarva Power would purchase the energy and capacity and a specified quantity of Renewable Energy Credits from 200 MW of the nameplate capacity of the project for 25 years following the commencement of commercial operation of the project. Last year, Bluewater reported that it had previously entered into a memorandum of understanding with the Delaware Electric Cooperative for the sale of a smaller amount of power from the same proposed project.

PPA followed a two-year process resulting from a competitive procurement for electric power from new electric generating facilities directed by a law enacted by the Delaware Legislature in 2006, regulatory directives by the Delaware Agencies, intensive contract negotiations between Delmarva Power and Bluewater Wind, and additional legislation unanimously enacted by the Delaware Legislature and signed into law by Governor Ruth Ann Minner earlier this year.⁴ The renewable energy produced by the Bluewater project (embodied in the Renewable Energy Credits associated with the project's production of electrical energy) would play a very substantial role in meeting Delaware's Renewable Portfolio Standard, which calls for retail electrical energy sales in Delaware to be provided with at least 20% of renewable energy by 2019.⁵

Under the competitive procurement process directed by the State Agencies, any person seeking to build a new power plant to be located in Delaware or, in the case of an offshore wind project, a project located off the coast of Delaware with a transmission line that would make landfall in Delaware, could have submitted a bid. While bids were submitted for a coal-fired plant and a natural gas-fired plant, only Bluewater submitted a bid for an offshore wind project.

Under the PPA between Delmarva Power and Bluewater, Bluewater is obligated to obtain the requisite leasing rights and environmental approvals so that it may build the project, including the submarine cable that would interconnect the project's wind turbine generators with the transmission grid in Delaware, in order to meet contractual deadlines and sell the power and RECs produced by the project at a fixed price. The price increases each year by 2.5 percent, but does not provide Bluewater Wind with the ability to increase its price based on capital or operational costs that are higher than projected. Moreover, Bluewater's ability to construct the project economically may depend on its ability to sell additional output from the project to other regional buyers at prices comparable to those under the PPA with Delmarva Power.

The Delaware Agencies approved the Bluewater PPA, finding that the Bluewater Project and the PPA would provide substantial long-term benefits, including environmental and energy price hedging benefits, despite the fact that the PPA was projected to result in net costs to Delmarva Power's customers over the 25-year period following commercial operation of the project.⁶ In other words, at this stage of the development of offshore wind power, we found that the economics of these types of projects are marginal relative to other electric power alternatives, but have other features that make them attractive. An important characteristic of offshore wind power is that it can produce carbon free power on a large scale, thus contributing to the mitigation of climate change.

⁴ An Act to Amend Title 26 of the Delaware Code Relating to Offshore Wind Power Installations, Senate Bill No. 328, [http://legis.delaware.gov/LIS/lis144.nsf/vwLegislation/SB+328/\\$file/legis.html?open](http://legis.delaware.gov/LIS/lis144.nsf/vwLegislation/SB+328/$file/legis.html?open).

⁵ Renewable Energy Portfolio Standards Act, as amended, 26 Del. C. §§ 351-363 (2008),

⁶ Order No. 7440 at 4; during the two years of the proceedings, there were a number of economic analyses conducted, which found to various degrees that the expected costs of the energy, capacity and RECs from the project would likely exceed their projected market value. See Independent Consultant's "Report on Final Power Purchase Agreement Between Delmarva Power and Bluewater Wind Delaware, LLC (July 3, 2008)

The Delaware Agencies represent various areas of responsibility and accountability within Delaware State Government—with the heads of the Office of Management and Budget and the Department of Natural Resources (of which the Energy Office is a part) serving in the Governor’s Cabinet, the Public Service Commission is an independent regulatory commission whose five part-time commissioners are approved by the Governor and confirmed by the Delaware Senate, and the Controller General is accountable to the Delaware Legislature. The Delaware Agencies have a substantial interest in the successful development, financing, construction, and operation of the wind farm planned to be constructed by Bluewater off the Delaware coast and, hence, have a substantial interest in the Proposed Rule and its potential impacts on the successful development, financing, construction and operation of the Bluewater project and offshore alternative energy projects in general.

II. Concerns of the Delaware Agencies With the Proposed Rule

The Delaware Agencies commend the MMS for the Proposed Rule, which appears in general to provide a viable regulatory framework for granting leases and other rights for alternative energy project development on the Outer Continental Shelf (OCS). Issuance of a final rule in the near future is an important and necessary step in the development of alternative energy (renewable energy) in the OCS. We urge MMS to promulgate a final rule by the end of this year. However, the Delaware Agencies have several concerns regarding certain aspects of the Proposed Rule pertaining to the process for leasing portions of the OCS for alternative energy development and provisions regarding royalty payments.

Under the Proposed Rules, a pioneering offshore wind energy developer, such as Bluewater, may submit an unsolicited application under Section 285.230 for a commercial lease for OCS alternative energy development. Unless the area is scheduled for a lease sale conducted by MMS, MMS will issue a public notice and consider comments received to determine if competitive interest exists under Section 285.231. If MMS determines that competitive interest exists in the lease area, the competitive bidding process will follow the procedures set forth for competitive bidding. If MMS determines that there is no competitive interest in the lease area, the rules pertaining to noncompetitive leases apply. Absent a waiver or exception, “MMS is proposing a royalty regime in which an *operating fee rate would apply at a rate of one percent in the first two years* following approval of the Construction and Operations Plan on commercial alternative energy leases, and at two percent thereafter . . . Where competition exists for a lease, MMS may offer bidders the opportunity to bid a constant or sliding operating fee rate above 2 percent subject to a fixed cash bonus.”⁷ Hence, there is a minimum royalty payment of 2%, which could be bid up further where competition exists for a lease. Moreover, royalty payments are not based on actual project revenues but imputed revenues according to a specified formula and they start accruing after approval of a construction plan, not when the project has been built and is producing power and receiving actual revenues.

⁷ 73 Fed. Reg. at 39,380 (emphasis in original).

The Delaware Agencies are concerned that the Proposed Rule could result in a party using the competitive leasing process to defeat, delay or impose undue costs on a developer, such as Bluewater, that has the capability and plan of building a wind project with the support of the coastal state, where the potential competitor would have little prospect and perhaps not even have the intent of itself successfully building an offshore wind farm itself.⁸ In addition, the Delaware Agencies are concerned that the minimum leasing rates for a non-competitive lease may be too high for development of offshore projects that, based on the information presented to us, have marginal economics. Finally, the Delaware Agencies have concerns regarding the appropriateness of the structure for determining how the annual operating fee that MMS would receive would be calculated.

The Delaware Agencies believe that the primary objective of the MMS should be the successful development of alternative energy in the OCS. It is likely that leasing rules focused on increasing the likelihood of successful development of offshore energy should also have the effect of maximizing revenues for the Federal Government in practice since successful development of offshore renewable energy will beget leasing revenues.

III. Recommendations to Address Concerns

A. Introduction

In order to address the concerns outlined above, the Delaware Agencies recommend modifications to the following sections of the Proposed Rules:

- Qualifications regarding who can bid (Subpart A, Section 285.107) and criteria to demonstrate a competitive interest in response to an unsolicited request for a noncompetitive lease (Subpart B, Section 285.231);
- Auction format for competitive leases, (Subpart B, Section 285.220) and Operating Fees Pursuant to Commercial Leases (Subpart E, Section 285.505).

The specific recommendations are set forth below.

B. Determination of Competitive Interest; Qualifications to Bid on a Lease

MMS has specifically sought comment “on the process we would use to obtain public input on unsolicited applications and the considerations for determining whether competitive

⁸ Indeed, the MMS itself has expressed similar concerns: “We want to encourage competition for OCS leases from entities that will diligently develop alternative resources and avoid situations where leases are acquired for strategic or purely speculative purposes.”

interest exists.”⁹ MMS has also asked “if the proposed leasing system and lease development requirements are appropriate to foster efficient development of OCS alternative energy resources, or whether there are other conditions or requirements that we should consider to prevent speculative bidding, holding and resale of the lease rights.”¹⁰

Our assessment is that offshore wind development under the Proposed Rule would be susceptible to delay or disruption by project opponents, developers with speculative interests, and companies without sufficient technical and financial qualifications. The OCS leasing rules could be significantly improved if the qualifications standards for bidders, including those that would seek to turn an unsolicited application by a project developer into a competitive process, were strengthened. As proposed, the qualifications standards in Sections 205.106 and 205.107 do not require that the prospective bidder have the financial and technical capability and intention to develop, finance, construct and operate the project and there is no requirement that prospective bidders submit information that would allow MMS to make a determination of such financial and technical capability and intention. The Delaware Agencies recommend that the qualifications standards be revised to require the filing of such information and that it be considered in determinations of whether a competitive interest exists with respect to an unsolicited application for a noncompetitive lease and whether a bidder in a competitive auction is qualified to bid. The Delaware Agencies support the recommendations of the American Wind Energy Association (AWEA) regarding the strengthening of qualifications standards in this regard.¹¹

MMS should be particularly skeptical of claims of competitive interest in sites where state officials have invested significant effort in work with a developer that has applied to MMS for a noncompetitive lease. A skeptical response is particularly appropriate where state agencies have formally decided to support a particular offshore wind project at a site on the OCS off their State’s coast. In the case of Delaware and the Bluewater project, for example, state officials have (a) after a competitive procurement among potential power suppliers, determined that Bluewater’s proposed offshore wind project would best serve electricity customers in the state, and (b) approved a power purchase agreement for a substantial portion of the project’s anticipated output. In the case of an Approved PPA Project such as Bluewater’s Delaware project, any entity that seeks to trigger competitive MMS leasing of the project site through an assertion of purported competitive interest should be required to demonstrate that it has a realistic business plan to obtain all permits and approvals needed from regional, state and local authorities, sell the electrical power and RECs from the project, and obtain financing to develop and construct the project.

In the face of a State’s carefully considered support for an Approved PPA Project, it is highly unlikely that any assertion of a competitive interest would be based on a bona fide business

⁹ 73 Fed. Reg. at 39,393.

¹⁰ 73 Fed. Reg. at 39,394.

¹¹ See American Wind Energy Association (AWEA) Comments to the Minerals Management Service Proposed Rule, Alternative Energy and Alternate Use of Existing Facilities on the Outer Continental Shelf, Regulation Identifier Number (RIN) 1010-AD30 (September 8, 2008) (hereinafter, “AWEA Comments”) at 9-14.

plan and intention to bid. An assertion of competitive interest in this circumstance is far more likely to reflect a desire to impede or defeat the existing state-supported proposal. Initiation of the competitive bidding process on the basis of a sham or purely speculative assertion of interest can delay and increase the costs an Approved PPA Project to the point where it may no longer be profitable or financeable. Thus, if the would-be competitive bidder cannot provide a clear and compelling account of how it will develop a wind farm on the site of an Approved PPA Project, MMS should determine that the would-be competitive bidder is not qualified to participate in the competitive leasing process. This approach would “foster efficient development of OCS alternative energy resources” and would help achieve MMS’ stated objectives—“to encourage competition for OCS leases from entities that will diligently develop alternative energy resources and avoid situations where leases are acquired for strategic or purely speculative purposes.”¹²

C. Lease Payment Structure; Minimum Lease Payments

The Delaware Agencies share the concerns expressed in the AWEA comments that the proposed minimum levels of operating lease fees are excessive and that in a competitive leasing framework, bidding based on cash bonuses rather than operating fees would best deter strategic or speculative bidding or bidding by unqualified companies.¹³ Specifically, we agree with capping the operating fees at one percent of revenues. This maximum level of operating fees should apply for holders of commercial leases obtained on a non-competitive basis (where no cash bonus would apply) and through a competitive auction process. In a competitive bidding process, winning bidders would be determined based on cash bonus bids (after consideration of the factors outlined in Section III.B of these comments). In this manner, there would be less reliance on operating fees, which may not be triggered, if they are triggered at all, until five years or so after a bid is submitted. Greater reliance on cash bonuses and rental payments, which would be paid at and from the start of the lease, would deter bids from those that are not seriously intending to develop the project, have a speculative purpose, or do not have the technical or financial qualifications.

In addition, the Delaware Agencies agree with the recommendations of AWEA with respect to the time period when operating fees should commence. Under the Proposed Rule, the operating fee would commence once a Construction and Operations Plan has been approved and continue for two years at one percent of imputed revenues and then increase to two percent of imputed revenues. However, actual revenues from these projects would not commence until construction has been completed and the production and sale of electrical power has commenced. The fee on imputed revenues should commence when actual revenues are obtained from the sale of electric power.

¹² 73 Fed. Reg. at 39,393.

¹³ See AWEA Comments at 5-6.

AWEA has correctly argued in its comments that the proposed definition of “P” in the imputed revenue formula is inappropriate to measure the wholesale value of the power from an offshore project since it represents a retail end-user price that includes distribution and transmission charges.¹⁴ We agree with AWEA that use of actual project revenues is a far superior measure of revenues. However, if MMS wants to use imputed revenues, a more suitable (but imperfect) measure would be the average standard offer service or default service rate in \$/MWh for electric power suppliers in the state that supply wholesale power requirements (or if there are not, the average wholesale cost of power supplied to or by the utility in question).¹⁵ We agree with AWEA that if an imputed revenues measure is used that lessees have the ability to reduce their payments if actual revenues are significantly lower than imputed revenues.¹⁶

IV. Conclusions and Recommendations

The Delaware Agencies support issuance of the Proposed Rules to foster alternative energy development in the OCS, with modifications to the financial aspects of the leasing rules proposed in these comments. In order to avoid further delays for development of offshore wind energy, the Delaware Agencies urge issuance of final rules by the end of this year. The Delaware Agencies believe that the modifications proposed, many of which are also proposed by the American Wind Energy Association and are set forth and explained in more detail in AWEA’s comments, will help spur development of alternative energy in the OCS while deterring strategic and speculative bidding as well as from bidders who are unlikely to be successful in developing OCS resources due to lack of technical or financial qualifications. In addition, our comments give recognition to actions of states that have supported specific offshore projects, at least through the authorization of power purchase agreements, as has Delaware, in the offshore leasing process in a manner that is consistent with both the overall framework of MMS’ proposed process and MMS’ objectives to encourage efficient development of alternative energy in the OCS while deterring strategic or speculative bidding.

¹⁴ See AWEA Comments at 46, -54-57.

¹⁵ While the wholesale requirements service provides products not ordinarily provided by an offshore wind project (such as load following, losses and ancillary services), energy provided at higher value hours and proportionately greater amounts of capacity, there are, on the other hand, proportionately less RECs included.

¹⁶ See AWEA Comments at 55-57.