January 20, 2012

Economics Division
Bureau of Ocean Energy Management
381 Elden Street, MS 4050
Herndon, Virginia 20170-4817

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COMMENTS OF CLEAN ENERGY STATES ALLIANCE ON BOEM AUCTION FORMAT INFORMATION REQUEST

Docket #: BOEM-2011-0095

Dear Director Beaudreau:

Clean Energy States Alliance (CESA) offers the following comments on the Bureau of Ocean Energy Management's (BOEM) Request for Information on the State of the Offshore Renewable Energy Industry – Auction Format Information Request (AFIR). CESA is a national non-profit organization that works with states to advance renewable energy policy, programs, finance, and technology innovation. CESA is a membership organization, composed of the major state clean energy programs in the country. CESA also facilitates a collaborative of state officials, federal agencies, non-governmental organizations, industry representatives, and other offshore wind (OSW) stakeholders with the objective of accelerating the development of a robust OSW industry in the U.S. – the Offshore Wind Accelerator Project.

In summary, CESA believes that the recommendations and preferences identified by BOEM in the AFIR will create significant hurdles to development of a domestic offshore wind industry. CESA is particularly opposed to the following two aspects of the proposed format:

1. BOEM's proposed use of a traditional, non-recourse cash bonus instead of an operating fee rate will present significant financing challenges to the nascent offshore wind industry in the U.S. as it will increase the cost of capital, drive up the cost of OSW projects, and impose a financial burden on state rate-payers.
2. BOEM's proposed use of Multiple Factor Auctions (MFA) in **only** limited circumstances, and then only with a discount of 25% or less for non-monetary factors, ignores the important role of states, state policy, public procurement, and state financial support for offshore wind.

RECOMMENDATIONS

To address these concerns, CESA offers the following recommendations:

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1. **Use of Operating Fee Rate versus Upfront Cash Bonus.** BOEM should employ an operating fee rate rather than a cash bonus to reflect the emerging nature of the OSW industry. The cash bonus approach, as proposed, requires winning bidders to pay the bonus bid upfront. This is unworkable for an OSW industry that is in its infancy in the U.S. and that faces particularly high costs of capital. The sector will only grow in the aggregate and in an accelerated timeframe to generate significant revenue for the federal government in the longer term if it is allowed to develop and reach commercial maturity more quickly. Therefore, BOEM's establishment of a bid system variable should be designed to encourage the development of OSW projects in the early years of the program through use of an operating fee rate or minimal cash bonus, implemented through installments.

   If BOEM is concerned that use of an operating fee rate will allow developers to abandon or delay projects or allow for undercapitalized bidders, these risks can be addressed by use of performance milestones, surety bonds, and/or other financial risk management tools.

   If BOEM rejects use of the operating fee rate approach, BOEM, at least, should allow bidders to pay for the cash bonus in installments over a ten year period. This feature would facilitate the maturing of the OSW industry in which developers face high financing costs to access upfront capital. BOEM's consultant, Power Auctions, recommends against this "installment" approach because, as used by the FCC for wireless service auctions, it performed poorly.

   In the 1990's, the FCC used installment payments as a means to satisfy a Congressional mandate to create opportunities for small businesses in the telecommunications sector. The BOEM consultant's objections are that (a) the FCC gave certain small developers "preferential treatment" and (b) there was ***one*** incident in which a licensee filed for bankruptcy and could not make installment payments. Ausubel & Cramton, AE Auction Design Study Paper 2 at 2-3.

   However, both of these objections can be addressed readily by BOEM while allowing for an installment payment approach to be used in the OSW context. First, the installment approach can be applied equally to all OSW developers, not just providing preferential treatment to a certain class of developers representing small business as FCC did. Second, to guard against possible future bankruptcy, if necessary, BOEM can require filing of surety bonds to guarantee performance or require a showing of developer capability as a key bid factor.

   If BOEM determines to use an upfront cash bonus approach, the agency should set a minimum reserve price at the lowest practical level to recognize that (a) OSW is a non-depleting use of the OCS, (b) there is are strong national policies in place that call for the increased deployment of renewable energy, and (c) a low reserve price will reduce the costs of capital, generation, and imposed on state ratepayers. While BOEM is statutorily obligated to obtain a "fair return" for leases on the OCS, the agency is empowered to consider the non-economic values contributed by OSW projects (e.g., no carbon emissions, no fuel costs, energy security, etc).

Moreover, there is no predetermined lease value established yet for this new industry. In October, 2010, BOEM did execute a lease agreement for the Cape Wind project in Massachusetts. Therefore, BOEM should consider using the cost of the Cape Wind lease as a reserve price.

BOEM also should recognize that, under current market conditions, OSW deployment is linked directly to the presence of specific state policies requiring procurement or providing subsidies for OSW. The imposition of additional costs for leasing, through use of cash bonus payments, will fall upon the electricity customers of individual states. That is, BOEM's use of an auction approach that results in high cash bonus bids will diminish industry support at the state level, make project financing and construction more difficult, and increase state ratepayer burdens. This will, in fact, represent an effective **transfer** of state ratepayer subsidies to the federal government, with a chilling effect on state support for OSW.

2. **Use of Multi-Factor Auctions.** BOEM's use of an auction format should be structured to recognize the critical role of states in creating demand, incentives, and policy support for OSW. Early projects in the U.S. will only be developed with state policy and ratepayer funding support. Therefore, BOEM should establish an auction approach that gives preferential treatment to those bidders that have an approved commitment for the sale of power from a proposed OSW project in any lease sale area from a state public utility commission, state power authority, federal agency, or other relevant public agency through a competitive process.

   For a prospective lessee who holds an approved commitment for the sale of power in a lease sale area through a competitive process implemented by a state-regulated utility, state public utility commission, state power authority, federal agency, or other relevant public agency, BOEM should assign the rights ***without*** a federal auction process and at the reserve price. In these situations, the state or federal agency-administered (or approved) competition for an OSW power purchase agreement (PPA) has achieved the objectives of the BOEM auction program: efficiency, competition, consistency, simplicity, and transparency.

   This approach also is consistent with BOEM's mandate to offer leases competitively. If BOEM finds that a state or federal agency has conducted a robust competitive process for selecting an OSW project that is equivalent to a BOEM auction process, the Bureau should waive the need for a second, duplicative competitive auction at the federal level. This approach also will have the positive effect of ensuring state regulators conduct rigorous, effective competitive solicitations for OSW to take advantage of the federal auction "equivalency" finding or waiver, which, in turn, will ensure further OSW cost reductions and technology innovations.

   BOEM states that "in certain limited situations, BOEM may determine that other factors, along with cash bids should be considered in determining how it issues leases, and, indirectly, how much winning bidders should pay." See AFIR at 11. BOEM also stated clearly in association with its 2009 regulations that it will give significant relevance to state competitive processes in considering the winning lessee and the required bid payment:

During the time that BOEM has been promulgating this rule, States of Delaware, New Jersey, and Rhode Island have conducted competitive processes and have selected companies to develop wind resources on the OCS. We believe that the pre-existing State processes are relevant to the competitive processes that BOEM is required to conduct following approval of this rule. We intend to do so by using a competitive process that considers, among other things, whether a prospective lessee has a power purchase agreement or is the certified winner of a competitive process conducted by an adjacent State.

Notice at 11-12.

However, the relevance of state processes should **not** be limited to those that were completed, enacted or developed during the promulgation of the 2009 Final Rule. The same equity considerations that applied to Delaware, New Jersey and Rhode Island should be applied equally to all states that are supporting the development of OSW projects. Any developer who can demonstrate a firm financial commitment, secured through a competitive state process that precedes leasing, should receive equal benefit regardless of whether or not that state had commenced such processes at the time of the 2009 Final Rule's publication.

Multiple Factor Auctions should be administered for all designated WEAs. This approach will ensure fairness and provide state policymakers with the incentive to support development of OSW. BOEM should work with all states through existing mechanisms such as the state Task Forces to ensure that leasing decisions take place at a time and in a manner that is complementary to policies and processes being used by states. It is vital that BOEM work in coordination with States to avoid a situation in which projects that have secured financial support through implementation of state policies, such as PPAs or ORECs, do not have access to the leases necessary to site the projects.

BOEM also states that it is unlikely to offer a bidder a discount of more than 25 percent on the basis of non-monetary factors (BOEM also intends to limit discounts to projects that are at least 100 MW in size – an arbitrary cutoff with no basis in law or regulations). Because state approvals are critical at this time to assist projects to gain access to financing, BOEM should offer a bidder a discount of at least **50 percent** on the basis of being a winner of a competitive process conducted by a public power authority, a state entity, or a federal agency.

BOEM's consultants argue that a smaller discount (<25%) is justified. They also argue that BOEM should eliminate consideration of factors that have significant outside benefits, as for example, "having a PPA that is approved by a state [since this] would undoubtedly yield much better access to the capital markets at more favorable rates, resulting in lower costs going forward." Ausubel & Cramton, paper 2, at 16. This reflects a fundamental misunderstanding of the reality of OSW financing today. While a state-approved PPA is critical to access financing, it is **not** necessarily sufficient to ensure favorable financing. To overcome the substantial financing challenges facing early projects, a significant additional bidder discount is warranted at the federal auction level based on the existence of a state commitment to provide subsidies to and/or enter into a PPA with a project developer.

The larger 50% discount percentage reflects the importance of facilitating state leadership actions and policies if offshore wind is to contribute to the nation's energy future. In the light of the increasing level of state support for OSW and the uncertainty of federal renewable energy policy incentives, it is critical for BOEM to reward and incentivize state actions to create demand and implement competitive procurement processes by providing successful winners of state approved-PPAs and related incentives a significant discount in the federal auction process.

There is no conflict with BOEM regulations or statutory authority by establishing this level of higher discount for a bidder that wins a state process which results in financial commitments. The Final Rule clearly contemplates a multi-factor auction based on financial bid variables and non-monetary variables including technical merit, timeliness, financing and economics, public benefits, **consistency with state and local needs, and requirements**. See Ausubel & Cramton, paper 2, at 12. There also are precedents for this level of discount. Most notably, the U.S. Department of Defense applies a 50 percent discount to domestic firms in their competition with foreign firms for defense contracts. See Ausubel & Cramton, paper 2, at 15.

In addition to the "state process winner" discount, BOEM should consider additional non-monetary factors in providing additional discount percentages. These should include:

- The applicant has conducted a site evaluation that BOEM and/or a relevant state agency has determined to be credible and indicates that the site is economically and environmentally viable
- The applicant has conducted NEPA-related assessments that EPA or BOEM find acceptable
- The applicant has constructed a meteorological tower

Thank you for your consideration of our recommendations and comments.

Sincerely,

Mark Sinclair
Executive Director
Clean Energy States Alliance