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Rigid COD deadlines do more harm than good

By Steven F. Greenwald and Jeffrey P. Gray

A utility executive responsible for procuring renewable power recently lamented that, at the time of contract execution, renewable “projects” are typically at a very preliminary stage of development, offering scant information about project specifics. Regulatory or other objectives often cause the utility to require that the power purchase agreement be executed before critical permits have been obtained, transmission arrangements have been finalized, or the quality of the project’s fuel source has been determined. The utility spokesperson contrasted this “amorphous” state of renewable projects as of contract execution with natural gas projects, which have far fewer “unknowns.”

Despite their recognition of the schedule challenges confronting renewable projects, utilities usually insist that project sponsors commit to an absolute, firm guaranteed commercial operation date (COD) and that substantial “daily delay” and other damages be imposed for any delay. Issues relating to the COD—including security, penalties, and reasons for not imposing delay penalties—typically emerge as the most contentious issue in negotiations.

Benefits of punitive COD deadlines are illusory

Utilities have legitimate reliability and economic interests to justify their demand that the COD be specified and that the supplier contractually commit to achieve that date. However, these needs do not justify imposing a “do or die” COD deadline accompanied by draconian penalties. Utilities rationalize these measures on the basis that they are “relying” on the project’s capacity to meet their load as of the “guaranteed” COD and are “providing” the project sponsor the necessary “incentives” to commence operating as soon as practicable.

Neither ground justifies the resistance to offering renewable projects some degree of scheduling flexibility. On the contrary, the insistence on “guaranteed” CODs increases project costs—to the detriment of the utility, electric consumers, and the project sponsor—while failing to increase the likelihood that the target COD will be achieved.

Ironically, an inflexible COD may be more likely to delay a project’s on-line date. The scheduling uncertainties endemic to developing a renewable project, coupled with harsh “late” penalties, offer the project sponsor a perverse incentive to commit to a later COD than is potentially achievable, because any risk of being “late” must be avoided. This risk of daily delay damages, coupled with the security the utility requires to cover that contingency, necessarily increases project costs.

Reliability is not threatened

The argument that the utility needs a hard and fast COD deadline to satisfy its capacity needs is overstated and misconstrues the overriding objective of renewable power. The specter that a utility with supply resources in the 10,000s of megawatts would be unable to serve its load or would be economically damaged by a

few weeks’ delay in a 30- or 40-MW biomass project—or even a 100-MW intermittent wind project—is just that: a specter. “Just in time” inventory programs promote efficiency for grocery chains, but they are a nonproductive distraction in promoting renewable generation. The capacity renewable projects offer is beneficial, but the overriding attractions of such projects are the displacement of fossil fuel generation and reduction in carbon emissions.

Project sponsors have strong incentives to achieve COD

The claim that utilities must resort to economic sanctions to incentivize projects to achieve contracted-for COD evidences a lack of understanding of the economics motivating independent power producers. Renewable projects have compelling economic incentives, independent of utility threats, to achieve COD as quickly as possible. In stark contrast to regulated utilities, which “earn” AFUDC (allowance for funds used during construction) “income” during a project’s precommercial period, for the independent producer, each day preceding COD accrues additional and nonrecoverable expenditures. The price at which the renewable producer commits to deliver power to the purchasing utility reflects an assumed COD and associated commencement of any return on investment; if COD is missed, project economics necessarily suffer—there is no backstopping by ratepayers.

The simple reality is that in many instances the schedule on which a renewable project can achieve COD is outside of the project’s control. Additional economic incentives do not enhance the sponsor’s ability to prevent delays caused by administrative and judicial challenges to necessary permits or by the purchasing utility being unable to obtain requisite regulatory approvals. In fact, when presented with the facts, in most instances, utilities and regulators excuse the delay in a project’s COD.

Proposed solution

The goal of utility procurement should be to enable the project sponsor to achieve the earliest COD at the least cost. Contract provisions imposing punitive measures for a late COD are more likely to result in later CODs and escalating prices. Utilities and regulators who are committed to advancing renewable power must recognize that firm schedules that may be appropriate for utility-owned or fossil fuel projects should not be assumed to work for renewable projects. One size does not fit all. Sincere proponents of renewable power should be receptive to flexible COD deadlines based on the project sponsor contractually committing to commercially reasonable measures to achieve a targeted date and to objective and nonpunitive standards by which the date can be advanced or deferred. ■

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