



Fuelcell Energy Annual Report 2018

Form 10-K (NASDAQ:FCEL)

Published: January 11th, 2018

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended October 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 1-14204

FUELCELL ENERGY, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-0853042

(I.R.S. Employer Identification No.)

3 Great Pasture Road

Danbury, Connecticut

(Address of principal executive offices)

06810

(Zip Code)

Registrant's telephone number, including area code: (203) 825-6000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, \$0.0001 par value per share

The Nasdaq Stock Market LLC (Nasdaq Global Market)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 28, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$54,054,838 based on the closing sale price of \$1.15 as reported on the NASDAQ Global Market.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class

Outstanding at January 2, 2018

Common Stock, \$0.0001 par value per share

75,678,919

DOCUMENT INCORPORATED BY REFERENCE

Document

Parts Into Which Incorporated

Proxy Statement for the Annual Meeting of Stockholders to be held April 5, 2018

Part III

FUELCELL ENERGY, INC.
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PART I**Item 1. BUSINESS**

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Forward-Looking Statement Disclaimer

This Annual Report on Form 10-K contains statements that the Company believes to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this Form 10-K, including statements regarding the Company's future financial condition, results of operations, business operations and business prospects, are forward-looking statements. Words such as "expects," "anticipates," "estimates," "projects," "intends," "plans," "believes," "predicts," "should," "will," "could," "would," "may," "forecast," and similar expressions and variations of such words are intended to identify forward-looking statements. Such statements relate to, among other things, the following:

- the development and commercialization by FuelCell Energy, Inc. and its subsidiaries ("FuelCell Energy," "Company," "we," "us" and "our") of fuel cell technology and products and the market for such products,
- expected operating results such as revenue growth and earnings,
- our belief that we have sufficient liquidity to fund our business operations for the next 12 months,
- future funding under Advanced Technologies contracts,
- future financing for projects including publicly issued bonds, equity and debt investments by investors and commercial bank financing,
- the expected cost competitiveness of our technology, and
- our ability to achieve our sales plans and cost reduction targets.

The forward-looking statements contained in this report are subject to risks and uncertainties, known and unknown, that could cause actual results to differ materially from those forward-looking statements, including, without limitation, the risks contained under Item 1A - Risk Factors of this report and the following:

- general risks associated with product development and manufacturing,
 - general economic conditions,
 - changes in the utility regulatory environment,
 - changes in the utility industry and the markets for distributed generation, distributed hydrogen, and carbon capture configured fuel cell power plants for coal and gas-fired central generation,
 - potential volatility of energy prices,
 - availability of government subsidies and economic incentives for alternative energy technologies,
 - rapid technological change,
 - competition,
 - market acceptance of our products,
 - changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States,
 - factors affecting our liquidity position and financial condition,
 - government appropriations,
 - the ability of the government to terminate its development contracts at any time,
 - the ability of the government to exercise "march-in" rights with respect to certain of our patents,
 - our changing relationship with POSCO Energy, which may affect our ability to develop the market in Asia and deploy SureSource power plants,
 - our ability to implement our strategy,
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- our ability to reduce our levelized cost of energy and cost reduction strategy generally ,
- our ability to protect our intellectual property,
- the risk that commercialization of our products will not occur when anticipated,
- our ability to generate positive cash flow from operations,
- our ability to service our long-term debt,
- our ability to increase the output and longevity of our power plants, and
- our ability to expand our customer base and maintain relationships with our largest customers and strategic business allies.

We cannot assure you that:

- we will be able to meet any of our development or commercialization schedules,
- any of our new products or technology, once developed, will be commercially successful,
- our existing SureSource power plants will remain commercially successful,
- the government will appropriate the funds anticipated by us under our government contracts,
- the government will not exercise its right to terminate any or all of our government contracts, or
- we will be able to achieve any other result anticipated in any other forward-looking statement contained herein.

The forward-looking statements contained herein speak only as of the date of this report. Except for ongoing obligations to disclose material information under the federal securities laws, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any such statement to reflect any change in our expectations or any change in events, conditions or circumstances on which any such statement is based.

Background

Information contained in this report concerning the electric power supply industry and the distributed generation market, our general expectations concerning this industry and this market, and our position within this industry are based on market research, industry publications, other publicly available information and assumptions made by us based on this information and our knowledge of this industry and this market, which we believe to be reasonable. Although we believe that the market research, industry publications and other publicly available information, including the sources that we cite in this report, are reliable, they have not been independently verified by us and, accordingly, we cannot assure you that such information is accurate in all material respects. Our estimates, particularly as they relate to our general expectations concerning the electric power supply industry and the distributed generation market, involve risks and uncertainties and are subject to change based on various factors, including those discussed under Item 1A - Risk Factors of this report.

As used in this report, all degrees refer to Fahrenheit ("F"); kilowatt ("kW") and megawatt ("MW") numbers designate nominal or rated capacity of the referenced power plant; "efficiency" or "electrical efficiency" means the ratio of the electrical energy generated in the conversion of a fuel to the total energy contained in the fuel (lower heating value, the standard for power plant generation, assumes the water in the product is in vapor form; as opposed to higher heating value, which assumes the water in the product is in liquid form, net of parasitic load); kW means 1,000 watts; MW means 1,000,000 watts; "kilowatt hour" ("kWh") is equal to 1kW of power supplied to or taken from an electric circuit steadily for one hour; and one British Thermal Unit ("Btu") is equal to the amount of heat necessary to raise one pound of pure water from 59°F to 60°F at a specified constant pressure.

All dollar amounts are in U.S. dollars unless otherwise noted.

Additional Technical Terms and Definitions

Advanced Technologies - Advanced Technologies projects involve the development of new products or applications based on existing carbonate technology or new electrochemical technologies. Examples are carbon capture, distributed hydrogen, solid oxide fuel cells and solid oxide electrolysis cell technologies. Advanced Technologies projects are typically externally funded by government or private sources and executed by our Advanced Technologies Group.

Availability - A measure of the amount of time a system is available to operate, as a fraction of total calendar time. For power generation equipment, an industry standard (IEEE (The Institute of Electrical and Electronics Engineers) 762, "Definitions for Use in Reporting Electric Generating Unit Reliability, Availability and Productivity") is used to compute availability. "Availability percentage" is calculated as total period hours since Commercial Operations Date less hours not producing electricity due to planned and unplanned maintenance divided by total period hours. Grid disturbances, force majeure events and site specific issues such as a lack of available fuel supply or customer infrastructure repair do not penalize the calculation of availability according to this standard.

Carbonate Fuel Cell ("CFC") - Carbonate fuel cells, such as the fuel cell power plants produced and sold by FuelCell Energy, are high-temperature fuel cells that use an electrolyte composed of a carbonate salt mixture suspended in a porous, chemically inert ceramic-based matrix. CFCs operate at high temperatures, enabling the use of a nickel-based catalyst, a lower cost alternative to precious metal catalysts used in some other fuel cell technologies.

Combined Heat & Power ("CHP") - A power plant configuration or mode of operation featuring simultaneous on-site generation from the same unit of fuel of both electricity and heat with the heat used to produce steam, hot water or heated air for both heating and cooling applications.

Commercial Operations Date ("COD") - The date that testing and commissioning of a fuel cell project is completed and the fuel cell power plant is operational with power being generated and sold to the end-user.

Distributed Generation - Electric power that is generated where it is needed (distributed throughout the power grid) rather than from a central location. Centrally generated power requires extensive transmission networks that require maintenance and experience efficiency losses during transmission while distributed generation does not. Distributed generation is small to mid-size power plants, typically generating 75 MW or less. Central generation is large power plants generating hundreds or even thousands of MW.

Micro-grids - Micro-grids are localized electric grids that can disconnect from the traditional electric grid to operate autonomously and strengthen grid resiliency. Micro-grids can be composed only of SureSource power plants due to their continual power output or combine a variety of power generation types such as fuel cells and solar arrays.

Nitrogen Oxides ("NOx") - Generic term for a group of highly reactive gases, all of which contain nitrogen and oxygen in varying amounts. Many of the NOx are colorless and odorless; however, they are a major precursor to smog production and acid rain. One common pollutant, Nitrogen Dioxide, along with particles in the air, can often be seen as a reddish-brown layer over many urban areas. NOx form when fuel is burned at high temperatures, as in a combustion process. The primary manmade sources of NOx are motor vehicles, traditional fossil-fuel fired electric utility generation, and other industrial, commercial and residential sources that burn fuels.

Particulate Matter ("PM") - Solid or liquid particles emitted into the air that are generally caused by the combustion of materials or dust generating activities. Particulate matter caused by combustion can be harmful to humans as the fine particles of chemicals, acids and metals may get lodged in lung tissue.

Power Purchase Agreement ("PPA") - A Power Purchase Agreement is a contract that enables a power user to purchase energy under a long-term contract where the user agrees to pay a predetermined rate for the kilowatt-hours delivered from a power generating asset while avoiding the need to own the equipment and pay the upfront capital cost. The PPA rate is typically fixed (with an escalation clause tied to a consumer price index or similar index), or pegged to a floating index that is on par with or below the current electricity rate being charged by the local utility company for a term of 10 to 20 years.

Renewable Biogas - Renewable biogas is fuel produced by biological breakdown of organic material. Biogas is commonly produced in biomass digesters employing bacteria in a heated and controlled oxygen environment. These digesters are typically used at wastewater treatment facilities or food processors to break down solid waste and the biogas produced is a byproduct of the waste digestion. Biogas can be used as a renewable fuel source for SureSource fuel cell plants located on site where the biogas is produced with gas cleanup, or it can be processed further to meet pipeline fuel standards and injected into a gas pipeline network, which is termed Directed Biogas.

Solid Oxide Electrolysis Cell (“SOEC”) - Solid Oxide Electrolysis Cells are electrochemical cells with the same cell and stack structure as Solid Oxide Fuel Cells, but are operated in reverse – instead of producing power from fuel and oxygen, SOEC cells produce hydrogen and oxygen from steam when supplied with power. The Solid Oxide Fuel Cell platform can be operated in fuel cell mode (producing power from fuel) or electrolysis mode (producing hydrogen from power) and can alternate between the two.

Solid Oxide Fuel Cell (“SOFC”) - Solid Oxide Fuel Cells are electrochemical cells with a non-porous ceramic material as the electrolyte. SOFCs operate at high temperatures (slightly higher than carbonate) eliminating the need for costly precious-metal catalysts, thereby reducing cost. Like carbonate, the high operating temperature enables internal reforming of the hydrogen rich fuel source.

Sulfur Oxide (“SOx”) - Sulfur oxide refers to any one of the following: sulfur monoxide, sulfur dioxide (“SO₂”) and sulfur trioxide. SO₂ is a byproduct of various industrial processes. Coal and petroleum contain sulfur compounds, and generate SO₂ when burned. SO_x compounds are particulate and acid rain precursors.

Overview

We deliver proprietary fuel cell power solutions for the clean and affordable supply, recovery and storage of energy. We serve utilities and industry and municipal power users on three continents with megawatt-class scalable solutions that include utility-scale and on-site power generation, carbon capture, local hydrogen production for transportation and industry, and energy storage. With more than 7.0 million megawatt hours of ultra-clean power produced, FuelCell Energy is a global leader in designing, manufacturing, installing, operating and maintaining environmentally responsible fuel cell power solutions.

We provide comprehensive turn-key power generation solutions to our customers, including power plant installation, operations and maintenance under multi-year service agreements. We develop projects and also sell direct to customers, providing either a complete solution of developing, installing and servicing the fuel cell power plant, or selling the power plant equipment only. For projects that we develop, the end user of the power typically enters into a PPA and we either identify a project investor to purchase the power plant and assume the PPA, or we retain the project and recognize electricity revenue ratably over the term of the PPA. We target large-scale power users with our megawatt-class installations. To provide a frame of reference, one megawatt is adequate to continually power approximately 1,000 average sized U.S. homes. Our customer base includes utility companies, municipalities, universities, government entities and a variety of industrial and commercial enterprises. Our leading geographic markets are the United States and South Korea. We are pursuing expanding opportunities in other countries.

Our value proposition is to enable economic value with clean and affordable fuel cell power plants that supply power where consumed. Our products can also be configured for recovery and storage applications. Our solutions are easy-to-site in populated areas as they are clean, operate quietly and without vibrations, and have only modest space requirements. Fuel cells use an electrochemical process to convert a fuel source into electricity and heat in a highly efficient process that emits virtually no pollutants as the fuel is not burned, generating power that is almost wholly absent of criteria pollutants such as NO_x that causes smog, SO_x that contributes to acid rain, and particulate matter that can aggravate asthma. Locating power generation near the point of use reduces reliance on the transmission grid, leading to enhanced energy security and power reliability. Utilities can minimize or even avoid the cost of transmission or other infrastructure by adopting distributed generation, which saves their customers the cost of installing and maintaining transmission and also avoids the losses associated with transmitting electricity over great distances. Our power plants provide electricity priced competitively to grid-delivered electricity in certain high cost regions and our strategy is to continue to reduce costs, which we believe will lead to wider adoption.

FuelCell Energy was founded as a Connecticut corporation in 1969 as an applied research organization, providing contract research and development. The Company went public in 1992 and reincorporated in Delaware in 1999. We began selling stationary fuel cell power plants commercially in 2003. Today, we develop turn-key distributed power generation solutions, operating and providing comprehensive service for the life of the asset.

Business Strategy

Our business model is to address power generation challenges with versatile, efficient and economical fuel cell solutions. We are leveraging our common core fuel cell technology and products to target global markets including on-site and utility-scale projects for the supply, recovery and storage of energy. We selectively utilize strategic business alliances and collaboration agreements for market development, financing and cost reductions. Our extensive intellectual property portfolio consists of patents, trade secrets and collective experience, which acts as a foundation for expanding and maximizing our solutions portfolio. Our business model is based on multiple revenue streams, including power plant and component sales; engineering, procurement and construction ("EPC") revenue; royalty and license revenue; recurring service revenue, including long term service agreements; recurring electricity sales under PPAs and tariffs for projects we retain in our generation portfolio; and revenue from public and private industry research contracts under Advanced Technologies.

Market adoption

We target vertical markets and geographic regions that value clean distributed generation, are located where there are high energy costs, and are aligned with regulatory frameworks that harmonize energy, economic and environmental policies. Our business model addresses all three of these policy areas with highly efficient and affordable distributed generation that delivers de-centralized power in a low-carbon, virtually pollutant-free manner. Geographic markets that meet these criteria and where we are already well established include South Korea, the Northeast U.S. and California. We have also installed and are operating plants in the United Kingdom, Germany, and Switzerland, have contracts and awards to install and operate plants in New York, and are pursuing further opportunities in Western Europe and certain other states in the United States as well as certain countries in Asia. We selectively develop strategic business relationships with some of the leading energy and power generation companies in our target markets to facilitate demand and deploy our projects.

While the Company has made significant progress with reducing costs and creating markets since the commercialization of our products in 2003, we face two primary challenges in growing the adoption of our distributed power generation solutions, which are (1) the need to further reduce the total cost of ownership, and (2) the continued education and acknowledgment of the value that our solutions provide. The business model for the generation and delivery of electricity for over a century has been central generation, which is large scale power generation in distant locations away from urban areas with transmission and distribution to the end users. Distributed generation enhances existing utility models and it is being embraced in an increasing number of markets to improve grid operations.

We work with utilities and power generators to demonstrate how our solutions complement central generation by incrementally adding clean power generation when and where needed. One example of this is a 40 megawatt fuel-cell only program by Long Island Power Authority ("LIPA") to address load pockets or power needs in specific areas of its service territory. LIPA operates in an area with high population density, scarce and expensive land, the need for resiliency to ensure power during storms, and vocal citizens that may not welcome new transmission lines in their neighborhoods. The structure of the program reflected the unique value drivers of fuel cells to cleanly, efficiently and economically supply power where it is needed, which for LIPA is near existing electrical substations. LIPA awarded the entire 40 MW program to FuelCell Energy through a competitive bidding process after a review of more than 375 MW of proposals from multiple developers.

Fuel cell power plant ownership structures

In the United States, historically, customers generally purchased our fuel cell power plants outright. As the size of our fuel cell projects has grown and availability of project capital improved, project structures have transitioned to predominantly PPAs. Under a PPA, the end-user of the power commits to purchase power as it is produced for an

extended period of time, typically 10 to 20 years. End-users may be a university, pharmaceutical company, hospital or utility. A primary advantage for the end-user is that it does not need to commit its own capital to own a power generating asset, yet it enjoys the multiple benefits of fuel cell power generation.

Once the PPA is executed, construction of the fuel cell project can begin. At or around the COD, the project may be sold to a project investor or retained by the Company. If the project is sold, revenue from the product sale is recognized. If the project is retained, electricity sales are recognized monthly over the term of the PPA.

Our business model is continuing to evolve to meet the needs and opportunities of the market and to best situate ourselves for success. In 2016, we began to retain ownership of certain projects through sale-leasebacks and retaining the related PPAs, thus keeping them on our balance sheet instead of selling them to an end-user customer, investor, or utility. Our decision to retain certain projects is based in part on the strong cash flows these projects can offer to us, the proliferation of power purchase agreements in the industry and the potential access to capital. Retaining PPAs affords the Company with the full benefit of future cash flows under the PPAs, which is higher than if we sell the projects. As of October 31, 2017, our operating portfolio of retained projects totaled 11.2 MW with an additional 19.5 MW under construction. The Company plans to continue to grow this portfolio in a balanced manner while also selling projects to investors when that presents the best opportunity.

Levelized Cost of Energy

Our fuel cell projects deliver power at a rate comparable to pricing from the grid in our targeted markets. Policy programs that help to support adoption of clean distributed power generation lead to below-grid pricing. We measure power costs by calculating the Levelized Cost of Energy ("LCOE") over the life of the project.

We innovate, design and own our proprietary fuel cell technology. We develop and execute comprehensive fuel cell turn-key projects or sell direct. We manufacture and install the fuel cell power plants and we then operate and maintain the plants for our customers under long term service agreements, or selectively retain projects in our generation portfolio. Given this level of integration, there are multiple areas and opportunities for cost reductions. There are several primary elements to LCOE for our fuel cell projects, including (1) Capital Cost, (2) Operations and Maintenance, (3) Fuel, and (4) Cost of Capital. We are actively managing and reducing costs in all four areas as follows:

- **Capital Cost** - Capital costs of our projects include cost to manufacture, install, interconnect, and any on-site application requirements such as configuring for a micro-grid and/or heating and cooling applications. We have reduced the product cost of our megawatt-class power plants by more than 60% from the first commercial installation in 2003 through our ongoing product cost reduction program, which involves every aspect of our business including engineering, procurement and manufacturing. Further cost reductions will be primarily obtained from higher production volumes which will lead to reductions in the per-unit cost of materials purchased, supported by continued actions with engineering and manufacturing cost reductions. On-site, our experienced EPC team has substantial experience in working with contractors and local utilities to safely and efficiently execute our projects and we expect continued cost reduction in this area with experience and continued transition to multi-MW fuel cell parks. Larger projects offer scale and the opportunity to consolidate systems and reduce costs. In addition to these cost reduction efforts, our technology roadmap includes plans to increase the output of our power plants which will add further value for our customers and reduce LCOE.
- **Operations and Maintenance** - We remotely monitor, operate, and maintain the fuel cell power plants to optimize performance and meet or exceed expected operating parameters throughout the plant's operational life. Operations and maintenance ("O&M") is a key driver for power plants to deliver on projected electrical output and revenue. Many of our service agreements include guarantees for system performance levels, including electrical output. Customers benefit from predictable savings and financial returns over the life of the contract, while minimizing risk. While the electrical and mechanical balance of plant ("BOP") in our power plants is designed to last 25 years, the fuel cell modules are currently scheduled for replacement every five years, the price of which is included in our service agreements. We expect to continually drive down the cost of O&M with an expanding fleet which will leverage our investments in this area. Additionally, we have completed the development of fuel cells that have a longer life, which will reduce O&M costs by increasing our scheduled module replacement period to seven years.