



**BEFORE THE
PENNSYLVANIA PUBLIC UTILITIES COMMISSION**

**Provider of Last Resort Roundtable
Docket No. M-00041792**

**Comments of Peter Adels, General Counsel
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Good afternoon. My name is Peter Adels. I am General Counsel of PennFuture, a statewide public interest membership organization working to enhance Pennsylvania's environment and economy, with offices in Harrisburg, Philadelphia and Pittsburgh. As many of you know, much of our work concerns energy policy, particularly in restructured electricity markets.

Thank you for the opportunity to present comments that focus on an issue not fully addressed by other commentators: the need to assure that POLR supply minimizes price and supply risks. A qualified POLR supplier must be expert at developing a balanced supply portfolio that minimizes price and supply risks. The inclusion of renewable resources and demand side response (DSR) are fundamentally necessary to do so. Since suppliers generally do not yet do so, there must be an overt POLR requirement to do so. Since doing so serves many other important public policy goals, such as increasing fuel diversity, limiting volatile natural gas prices for home heating and other uses, increasing our energy security, and enhancing the economy, public health and our environment, renewables and DSR must be appropriately maximized in POLR service.

Governor Rendell has proposed a comprehensive package of clean energy measures, with a 10% portfolio standard as the centerpiece for many of these same reasons. Governor Rendell's proposal would require all suppliers, including POLR suppliers, to provide 10% of supply from preferred resources within 10 years.

Three pending bills, H.B. 2250, S.B. 1030 and S.B. 962, impose similar requirements. These bills have been introduced by key legislative leaders from both sides of the aisle and all parts of Pennsylvania. Senate Republicans, for example, who are sponsoring RPS legislation, include Senators Erickson, Conti, Waugh, Orie, Piccola, Earll, Pippy, Rafferty, and M. White. Senate Democrats who are sponsoring RPS legislation include Senators Musto, Kukovich, Schwartz, C. Williams, Boscola, Stack, Ferlo, Costa, Tartaglione and Wagner.

While these measures are good policy for legislators from both parties, for the Commission, for Pennsylvania, and indeed for the nation for many reasons, there are

specific reasons why maximizing the appropriate use of renewables and DSR is fundamental to the core of POLR service.

66 Pa. C.S. Section 2807(e) (3) specifies that POLR service is required in the event that contracted electric energy is not delivered or if a customer does not choose a competitive supplier. POLR service is intended to be available and affordable for customers who do not, but more importantly, *cannot* obtain service from a competitive supplier. POLR service is intended to be *always* available (to the extent that the electricity system remains functioning.) As such, POLR supply must be generally a *lowest reasonable risk* product, from both the supply and price perspective. Renewable energy and DSR are key tools to make POLR service less risky and *these tools are severely underutilized in current practice*.

Thus, a core requirement for POLR service must be, as an ongoing principle incorporated into Commission regulations, to include the maximum appropriate level of both renewable resources and demand response as necessary to hedge risks of price and supply uncertainty. At this point in time, the requirement should certainly be no less than the 10% in 10 years that Governor Rendell wants as well as a fully available DSR program. A POLR supplier must at a minimum fully participate in PJM DSR programs and have the incentive to minimize peak supply costs, including appropriately full utilization of available EDC metering and other technology. In this regard, PennFuture strongly supports the comments presented by PJM on April 8.

Other than establishing such specific minimum standards, POLR regulations should not specify detailed programs or standards because circumstances change over time and hedging supply and price risk requires a careful balance. Rather, POLR regulations should assure compliance with the foregoing principles and minimum standards and otherwise rely on the statutory direction that a POLR supplier may be the former monopoly or alternative supplier and that the POLR supplier “shall fully recover all reasonable costs.” Reasonable costs include pollution free, zero fuel cost renewable energy. The selected POLR supplier(s) should be the ones(s) that will provide a balanced portfolio that best hedges supply and price risk (and meets other appropriate

requirements), including the maximum reasonable inclusion of renewable resources and DSR. The regulations should specify that reasonable costs to meet POLR supply are those that balance the POLR concerns of minimizing price and supply risk. POLR suppliers must clearly be put on notice that they will not recover higher electricity costs if natural gas skyrockets in price if they did not prudently minimize the risk by obtaining a diversified supply portfolio that prudently hedged risks by including renewable energy. The POLR supplier must have the incentive to have an adequate DSR program in place to sufficiently shave load during price peaks.

Each individual purchase decision need not be for the least cost MWH of electricity, but it must be part of a balanced supply portfolio that can reasonably be expected to maintain lower prices with reliable supply over the longer term. POLR service is not intended to be necessarily the lowest cost or the highest quality generation product or service available. Indeed the policy underlying the Restructuring Act is to promote competitive service while making sure that a “last resort” nevertheless is available. Including renewable energy and DSR in the supply for POLR service is necessary in order to accomplish the statutory goal of reasonably priced but not necessarily lowest cost supply.

Why a POLR requirement? While the foregoing principles already are widely accepted, many still have not widely embraced supply diversity and demand side response as part of a balanced portfolio that minimizes price and supply risk. Through 2003, the demand side of the market remained severely underdeveloped and arguably is the single greatest failure of restructured markets to date. In 2003, more than 53% of the electricity generated in PJM still was produced from coal, almost 33% was produced from nuclear plants, and more than 10% was generated from oil and natural gas. About 2% was generated from hydro projects, while about 1.2% was generated from all other resources combined. While natural gas still has a much smaller market share than coal or nuclear, we already are close to using too much natural gas to make electricity. A huge amount of new capacity has been added to PJM in the last few years, almost all of it fired by natural gas.

In the last two years, natural gas prices have nearly tripled while oil and coal prices have roughly doubled. Higher fossil fuel prices pressure higher electricity prices, especially since natural gas is increasingly the marginal fuel.

Yet to date, only one POLR supplier, Duquesne, has formally proposed including renewable resources and DSR to hedge supply and price risks. While a welcome development, the proposal still would require only 1.4% of renewable supply for 2005-2007 and 2.8% of renewable supply through 2010. In contrast, assuming the same effective date of January 1, 2005, Governor Rendell's proposal requires 2.5% advanced energy in 2005 and 6% by 2010. On DSR, the Duquesne proposal only is to discuss. Thus, the Duquesne proposal does not include enough renewable energy soon enough or any DSR commitment to be a meaningful step towards a more diverse resource portfolio to hedge supply and price risk.

A POLR requirement also is necessary even if a statewide RPS is adopted. While a statewide RPS is supported by fuel supply, cost, and diversity concerns, it is substantially focused on general economic development, public health, and environmental concerns. While a POLR requirement is supported by such other concerns, it is more focused on supply and price risk. The balance of cost and risk hedging is inherently different.

The importance of hedging. Under current circumstances, it is easy to see how important renewables and DSR can be to hedge volatile natural gas supply and price. Virtually all of the new electric power generation facilities being built today are fired by natural gas. More renewable generation decreases the demand for new natural gas generation, moderating both the price and supply risks of relying on natural gas for new generation. Similarly, shaving peak demand decreases the demand for peak generation that is provided by natural gas. Since natural gas is the marginal fuel that establishes the clearing price for all electricity, a substantial increase in new renewables or DSR that decreases reliance on natural gas provides downward pressure on all electricity prices. The beneficiary is not only the individual POLR supplier but all purchasers of electricity. The benefits go further. Decreasing the marginal use of natural gas to generate electricity reduces cost pressures on households and others using natural gas for heating as well as

those industries – such as the chemical and fertilizer industries – that use natural gas as a feedstock.

Some comments on cost. Because prices and markets cannot be accurately predicted, it cannot be known for sure in advance whether a renewable requirement or increased DSR program ultimately will increase or decrease POLR costs. We do not know whether a perceived risk will come to fruition, but minimizing supply and price risk of course are well accepted tools with a present value of their own.

When it comes to renewables, costs are routinely exaggerated for both political/advocacy and basic economic reasons. For example, the New Mexico RPS initially was projected to increase costs by \$300 million. But fossil fuel prices rose and renewable energy costs came down, and when bids were opened bids for renewable energy, the utilities discovered that the state's consumers would in fact save \$15 million because of the RPS.

With technological improvements and economies of scale, wind power in particular, but methane recovery and other renewables as well are increasingly competitive. When natural gas prices are above \$5.80 per MMBtu — a price threshold that was reached in 2003 in this region and reasonably may be expected to be reached during the next few years-- it is actually cheaper to generate electricity from wind than natural gas.

The cost of buying new wind under a long term contract is only about \$50/MWH or less. Depending on one's expectations of electricity prices, even the immediate incremental cost of buying renewables is small, and is spread considerably if the renewable supply is a small portion, such as 10%, of total supply. Once supply and price risk hedging is considered, any modest near-term incremental additional cost is a bargain.

Conclusion. In keeping with Governor Rendell's policies, PennFuture strongly recommends that POLR service includes a minimum of 10% preferred energy and otherwise maximizes the inclusion of renewable resources and DSR in order to hedge

price and supply risks. Failure to take this step will undermine the Governor's important initiatives that will protect PA energy security.