BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of the Alternative Energy Portfolio Standards Act of 2004	:	Docket No. M-00051865

COMMENTS OF THE OFFICE OF CONSUMER ADVOVATE

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I. INTRODUCTION

On November 30, 2004, Governor Edward Rendell signed Act 213 of 2004, the Advanced Energy Portfolio Standard ("AEPS"). Under the AEPS, entities supplying electric generation service to retail electric customers in Pennsylvania will be required to provide a certain percentage of the energy sold to their customers from advanced energy sources such as solar photovoltaic or other solar energy source, wind power resources, large scale hydropower facilities, low-impact hydropower resources, geothermal sources, biomass energy facilities, biologically derived methane gas facilities, fuel cells, coal mine methane, waste coal facilities, municipal solid waste facilities, distributed generation, demand side management, and other resources enumerated in the Act. The Act provides for the phase-in of the specific portfolio requirements so that by the fifteenth year after enactment, 18% of the energy sold to Pennsylvania retail consumers comes from the enumerated resources.

Under Act 213, the Commission will be required to establish regulations, policies and procedures to ensure that Act 213 is fully implemented. The Commission, through a Secretarial Letter issued January 7, 2005, is seeking comment on some of the key implementation issues and is establishing a Technical Conference to initiate discussions of the many regulations, policies and procedures that will be necessary to implement Act 213. The Office of Consumer Advocate ("OCA") supports the Commission's initiative to quickly begin the process of considering the issues related to the implementation of the Act. Act 213 has many potential benefits for both consumers and the Commonwealth, but these benefits may only be realized through well-reasoned policies, procedures and regulations implementing the Act.

Of particular concern to the OCA is the implementation of Act 213's provisions regarding recovery of the costs incurred by the provider of last resort entities in Pennsylvania for complying with Act 213. If cost recovery is not done in an appropriate manner, customers may end up paying unreasonable prices for the resources. As Act 213 is written, ratepayers could be required to pay a substantial deferred balance in the first year after the generation rate caps expire. This deferral relates to the costs for voluntary compliance by an electric distribution company ("EDC") incurred during its remaining generation rate cap period or the period of its Commission-approved generation rate plan. If the cost recovery provisions are not implemented properly, it is possible that a double recovery of costs could occur through these deferrals during the remaining transition period. Since costs for many of the resources that qualify as alternative energy sources are already reflected in current generation rates or the stranded cost recovery awarded to the EDC, the Commission must ensure that only incremental costs are the subject of any deferral. As can be seen, careful implementation of the cost recovery provisions will be necessary to avoid excessively burdening ratepayers.

There are other impacts from Act 213 that the Commission will need to explore thoroughly in other dockets. For example, Act 213 may have a significant impact on the Commission's proposed Rulemaking regarding the Provider of Last Resort Obligation. The OCA will more thoroughly discuss the impacts of Act 213 on the rulemaking in its comments on the proposed POLR regulations. The OCA would note that creation of an alternative energy portfolio standard may require an overall portfolio approach to meeting the POLR obligation so that all benefits of the alternative energy sources are reflected to the consumer. Additionally, it is possible that the cost recovery provision of Act 213, which calls for an automatic, reconcilable energy adjustment clause for the cost of the alternative energy sources, may require the use of

the same type of mechanism for other POLR costs, so that the costs and benefits of the alternative energy sources are properly reflected in rates.

The OCA will primarily focus these comments, and its presentation at the January 19, 2005 Technical Conference, on the deferral and cost recovery issues. The OCA will provide some brief comments on other topics listed in the Commission's Secretarial Letter in these Comments. As these issues progress, the OCA expects to comment more fully on all of the issues identified by the Commission.

II. COMMENTS ON SPECIFIC ISSUES

A. Force Majeure (Availability and Qualification of Eligible Resources)

The OCA has no specific comments at this time on this issue but looks forward to participating in the discussion of this issue in the Technical Conference.

B. Deferrals and Cost Recovery

1. Introduction

The cost recovery provisions of Act 213 are primarily found in Section 3(A)(3) under the heading of General Compliance and Cost Recovery. Also relevant to this issue is Section 3(d) regarding the exemption during the cost recovery period, and Section 3(e)(7) regarding the banking of credits during the exemption period. As noted in the Commission's identification of the issue, there are two aspects to cost recovery. First, is the deferral of costs that the EDC voluntarily incurs during its "cost recovery period," *i.e.* the time during which it continues to collect a ("CTC") or is under a Commission-approved generation rate plan. The second aspect is the on-going recovery of the costs incurred to comply with the Act after the cost recovery period. The Act allows recovery of those costs on a full and current basis through an automatic energy adjustment clause pursuant to Section 1307 of the Public Utility Code.

As a preliminary matter, the OCA submits that the guiding principle of the Public Utility Code that must be applied is that all rates must be just and reasonable. Section 1301 of the Public Utility Code specifically states:

> Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission.

66 Pa.C.S. §1301. The Public Utility Code provides a number of means for the Commission to establish just and reasonable rates, such as through general base rate filings, non-general base rate filings, and through adjustment clauses pursuant to Section 1307. In this instance, the General Assembly has directed that Section 1307 be used as the mechanism for the recovery of the costs incurred to comply with Act 213. Section 1307(a) provides:

> Any public utility . . . may establish a sliding scale of rates or such other method for the automatic adjustment of rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility, to be determined upon such equitable or reasonable basis as shall provide such fair return. . . . The Commission may revoke its approval at any time and fix other rates for any such public utility if, after notice and hearing, the commission finds the existing rates unjust or unreasonable.

66 Pa.C.S. §1307(a).

Whether recovery of the costs incurred to comply with Act 213 is through the deferral mechanism or through the on-going automatic adjustment clause, the Public Utility Code requires that the rates charged to consumers be just and reasonable. 66 Pa.C.S. §§1301, 1307. To ensure that this requirement is met, the Commission will need to establish a process through which the costs incurred by the EDC to comply with Act 213 are periodically reviewed for prudence and reasonableness. As natural gas cost purchases are now reviewed under Section 1307(f), and as energy costs were periodically reviewed when there were energy cost rate

("ECR") mechanisms under Section 1307, the recovery of costs of alternative energy sources to comply with Act 213 must be reviewed by the Commission pursuant to Section 1307 and found to be just and reasonable. At this time, the OCA does not propose specific standards, or a specific process that may be appropriate to apply in this review, but further consideration of this issue and the development of a process for this review is necessary.

With this background, the OCA will discuss additional issues and details regarding the deferral of costs to comply with Act 213 and the on-going recovery of the costs to comply with Act 213 after each EDC's "cost recovery" period is completed.

2. Deferrals

Act 213 exempts an EDC from meeting the Act's purchasing requirements during its remaining "cost recovery period" which is defined as the period while the EDC is still subject to a generation rate cap or a Commission-approved generation rate plan. Act 213, however, allows an EDC to voluntarily begin to meet the requirements of the Act during this time period and bank any credits for use in the first two years following the expiration of its cost recovery period. Section 3(e)(7). The EDC is permitted to defer the costs of this voluntary compliance for later recovery in the first year after the expiration of its rate cap or the generation rate plan. Section 3(A)(3). In relevant part, the cost recovery provision of Act 213 provides:

> (3) All costs for:
>
> (I) The purchase of electricity generated from alternative energy sources, including the costs of the regional transmission organization, in excess of the regional transmission organization real-time locational marginal pricing, or its successor, at the delivery point of the alternative energy source for the electric production of the alternative energy sources; and
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> (II) Payments for alternative energy credits, in both cases that are voluntarily acquired by an electric distribution company during the cost recovery period on behalf of customers shall be deferred as a

> regulatory asset by the electric distribution company and fully recovered, with a return on the unamortized balance, pursuant to an automatic energy adjustment clause under 66 PA. C.S. § 1307 (relating to sliding scale of rates; adjustments) as a cost of generation supply under 66 PA. C.S. § 2807 (relating to duties of electric distribution companies), in the first year after the expiration of its cost recovery period.

Section 3(A)(3). The closely related "banking" provision that must be considered when reviewing the deferral and cost recovery section provides as follows:

> (7) An electric distribution company or an electric generation supplier with sales that are exempted under subsection (d) may bank credits for retail sales of electricity generated from Tier I and Tier II sources made prior to the end of the cost-recovery period and after the effective date of this act. Bankable credits shall be limited to credits associated with electricity sold from Tier I and Tier II sources during a reporting year which exceeds the volume of sales from such sources by an electric distribution company or electric generation supplier during the 12-month period immediately preceding the effective date of this act. All credits banked under this subsection shall be available for compliance with subsections (b) and (c) for no more than two reporting years following the conclusion of the cost-recovery period.

Section 3(e)(7). It is important to note that properly applying these provisions is necessary to avoid a double recovery of the cost of alternative energy source supply that are already included in generation rates or stranded cost recovery received by the EDC.

Alternative energy sources under Act 213 are defined to include both existing sources and new sources. Section 2 (Definitions). But, the banking provision during the cost recovery period only applies to new or incremental sources, and similarly, the OCA submits that the deferral provisions should only apply to new or incremental sources. There are many existing resources that qualify as alternative energy resources. Many of these resources are those resources previously owned by electric utilities in Pennsylvania or are resources that have been

under contract, such as PURPA contracts, with Pennsylvania electric utilities. For example, large hydropower facilities or pumped storage facilities, such as Holtwood, Conowingo, Muddy Run or Bath County, may now qualify as alternative energy sources under Act 213. PURPA contracts, such as those with waste coal facilities or municipal solid waste facilities, may also qualify as alternative energy sources. The costs of these facilities, however, are currently reflected in EDC generation rates and are, or were, a part of the stranded costs paid by consumers. See, *e.g.*, §§2803 and 2808. It would therefore make no sense to allow EDCs to defer any of these costs under Act 213 for future recovery.

To properly implement the deferral provisions and the banking provisions of Act 213 that are applicable during the remaining generation rate cap or Commission-approved generation rate plan period, the Commission must first make a baseline determination as to which of the existing facilities that now qualify as alternative energy sources are currently reflected in the generation rates and stranded cost awards of each utility. This would also include any alternative energy sources that the EDC has under contract to provide energy to its retail customers, such as any wind energy contracts entered into in recent years. After determining this "baseline" of alternative energy sources that are reflected in the current rates and the stranded cost awards, the Commission will then be a position to determine the costs that are incremental to those reflected in generation rates and stranded cost charges. These incremental costs would be the proper subject of deferral under Act 213. In this way, any potential double recovery of costs – once through generation and stranded cost rate recovery and once through the deferral – can be avoided. In other words, the Commission must establish a procedure that does not allow an EDC to defer costs for which it is currently receiving rate recovery or has received stranded cost recovery. Any implementation of the Act that allows such

double recovery would be inconsistent with the intent of the legislation, as well as unjust and unreasonable.

The OCA recommends that the Commission require each EDC to identify all resources included in its generation rates or stranded cost recovery that qualify as existing alternative energy resources. This review could be conducted along with the baseline review that is necessary under Act 213's banking provisions. Under Section 3(e)(7), only credits associated with sales of electricity from alternative energy sources that exceed the EDC's sales from such sources in the prior 12-months may be banked for use later.[1] Following this review, the Commission should establish a process whereby an EDC that wishes to defer costs of additional alternative energy sources can request deferral of the costs from the Commission. The Commission should then review the costs for reasonableness and prudence prior to granting an order approving the deferral. The Commission may wish to undertake this review on an annual basis if the EDCs anticipate the need to defer costs for a significant number of resources.

3. On-Going Cost Recovery

After the expiration of the generation rate cap, or the Commission-approved generation rate plan, the costs of complying with Act 213 are allowed to be recovered on a full and current basis pursuant to an automatic energy adjustment clause. The relevant cost recovery section provides:

> (3) . . . After the cost recovery period, any direct or indirect costs for the purchase by electric distribution [companies] of resources to comply with this section, including, but not limited to, the purchase of electricity generated from alternative energy sources, payments for alternative energy credits, cost of credits banked, payments to any third party administrators for performance under this Act and costs levied by a Regional Transmission Organization to ensure that alternative energy

[1] The OCA would recommend the use of calendar year 2004 to establish the baseline for the banking of credits.

> sources are reliable, shall be recovered on a full and current basis pursuant to an automatic energy adjustment clause under 66 PA.C.S. § 1307 as a cost of generation supply under 66 PA.C.S. § 2807.

Under this provision, the recovery of the costs associated with compliance with Act 213 are to be recovered through an automatic adjustment clause. It is not clear to the OCA whether an EDC may elect, or the Commission may allow, recovery of the cost of compliance through another mechanism such as a fixed, non-reconcilable POLR charge.

As discussed above, pursuant to Section 1307, the Commission will need to adopt procedures to review the purchases to ensure that the rates are just and reasonable. The Public Utility Code is clear that all rates, including those under a Section 1307 automatic adjustment clause, must be just and reasonable. To ensure that rates are just and reasonable, the Commission will need to conduct a review of an EDC's purchases of alternative energy sources to determine that the purchases are reasonable and prudent. Subject to such a determination, the costs can be recovered through the automatic adjustment mechanism.

Also as mentioned earlier, this provision has a significant impact on the Commission's Rulemaking regarding the provider of last resort obligation. The OCA will discuss the impact of Act 213, and this recovery provision, in more detail in its Comments on the proposed Rulemaking. In general, however, the OCA is concerned that if recovery of one type of generation resource is through an automatic adjustment clause, it may be difficult to recover other POLR costs in a different manner. At this time, it is unclear to the OCA how one portion of the POLR resources, which have a direct impact on the need for and type of other resources that must be procured, can be recovered through a different mechanism. Alternative energy sources have benefits to the POLR, such as providing hedges against fossil fuel price increases,

that will directly impact the remaining POLR portfolio. The recovery mechanism for other POLR costs will have to be designed to capture the benefits of the alternative energy portfolio standard resources.

The Commission has processes in place for the review of automatic adjustment mechanisms, such as the review of natural gas purchases, the review of the old energy cost rate, and the review of CTC/ITC reconciliations. Depending on the level of review that the Commission finds necessary, the Commission could adapt the appropriate process to the review of the purchase of alternative energy sources under Act 213. Some type of procedure such as that utilized for natural gas companies Purchased Gas Cost Adjustment mechanism or the complaint procedure used to review Energy Cost Rate Adjustment mechanisms, may be the most appropriate guides at this time. The Commission may also wish to incorporate its review of these purchases into its larger review of an EDC's provider of last resort purchasing plan when that process is more formally established.

The OCA recommends that the Commission establish regulations governing the automatic energy adjustment clause and establish a process for review. While the on-going recovery mechanism may not be implemented for most EDCs until after 2007, the Commission-approved generation rate plans for some smaller EDCs, such as UGI and Pike County, will be ending in 2005 and 2006. The Commission may wish to establish some interim guidelines while a formal rulemaking process is proceeding.

C. Creation of An Alternative Energy Credits Program and Trading Platform

The creation of the alternative energy credits program and trading platform that will provide for verification, tracking, and trading of the alternative energy credits will be vital to the success of the program. Creating this program from scratch could also be a costly

proposition that unnecessarily increases the costs of alternative energy sources to consumers. The OCA encourages the Commission to utilize systems and processes that are either operating or under development to most efficiently implement these programs. The OCA is aware that PJM has been developing a tracking and verification program known at the PJM Generator Attributes Tracking System ("GATS").

The OCA would strongly encourage the Commission to work with PJM and its GATS to determine if this system can serve as the entity to establish the necessary programs. OCA staff has been involved in the development of GATS for some time. It is the OCA's understanding that the PJM GATS has the open architecture needed to accommodate all of the alternative energy sources identified in Act 213. It is also the OCA's understanding that New Jersey and Maryland plan to incorporate GATS as the basis for verification and tracking under their states' renewable resource portfolio standards. Thus, GATS is growing into a true regional standard that offers the advantage of being able to track all resources produced within the PJM RTO as well as imported resources that can be verified as complying with the GATS standards.

The PJM GATS is in its final design phase and working now with PJM could ensure that Pennsylvania's needs are incorporated into the final design. Although GATS is not operational at this time, it is unlikely that any alternative system could be designed from the ground up any sooner than when GATS is scheduled to be fully operational. The OCA strongly suggests that the Commission immediately contact PJM to open discussions on this issue.

The use of the PJM GATS may not fully address the need for verification and tracking for all Pennsylvania EDCs, however. Pennsylvania Power Company ("Penn Power") and Pike County Power & Light Company ("Pike") are not a part of the PJM Regional Transmission Organization, but rather are tied to the Midwest Independent Transmission System

Operator ("MISO") and the New York Independent System Operator ("NYISO") respectively. The Commission will need to explore further what systems may be necessary for Penn Power and Pike.

D. Alternative Compliance Payments

Act 213 provides for an alternative compliance payment if, at the end of any program year, the Commission determines that an EDC or EGS has failed to comply with the requirements of Act 213. See, Section 3(f). There are two alternative compliance payments under the Act – one for failure to meet the requirements for solar resources and one for failure to meet the requirements for the other alternative energy sources. For failing to meet the solar requirements, the alternative compliance payment is established at 200% of the average market value of solar renewable energy credits sold during the reporting period. For failure to meet the requirements for all other alternative energy sources, the alternative compliance payment is set at $45 times the number of alternative energy credits (1 credit = 1 Mwh of alternative energy source), *i.e.* $45/Mwh. Prior to imposing the alternative compliance payment, the Commission is required to provide notice and hearing. The dollars received from the alternative compliance payments are transferred to Pennsylvania's sustainable energy funds through the PA Sustainable Energy Board.

It is not clear to the OCA whether the alternative compliance payments are intended to be a penalty, a fine, a payment in lieu of a purchase, or some hybrid. The provisions regarding the transfer of the payments to the sustainable energy funds specifically refers to the disposition of fines and penalties under Section 3315 of the Public Utility Code. Section 3(g)(1) of Act 213 requires that the payments be made to the sustainable energy fund notwithstanding

Section 3315 which requires penalties and fines to be credited to the General Fund.[2] This distinction is important because generally, fines and penalties incurred by utilities cannot be passed on to consumers.

The OCA submits that it appears as if the General Assembly considered that the alternative compliance payment could act as a fine or penalty in certain circumstances. The solar alternative compliance payment appears to act as a fine or penalty. The value of the solar payment is established at 200% of the market value for solar resources. By definition, it would appear imprudent to effectively pay 200% of the market value for a resource if in fact such resource is physically available in the market for far less. A payment that is significantly above the market value of the resource that must be acquired clearly serves as a penalty or fine for failing to comply with the requirement to acquire the resource.

On the other hand, the alternative compliance payment for failure to meet the requirements for non-solar resources, *i.e.* the $45/Mwh, is not stated as an increment to the market price of the alternative energy sources. As set forth in the Act, the $45/Mwh alternative compliance payment could serve as a penalty in some circumstances, but in other circumstances, the $45/Mwh may serve as a form of price cap to be utilized if the price of alternative energy resources is too high.

For example, if an EDC incurs a $45/Mwh alternative compliance payment rather than pay a $100/Mwh premium for an advanced energy resource, it would seem that the alternative compliance payment may serve as a form of price cap for the procurement of the alternative energy source. In this circumstance, paying $45/Mwh rather than $100/Mwh would appear to be a reasonable compliance strategy and the alternative compliance payment would be

[2] A reference is also made to assessments and fees in the transfer provisions and requires transfer notwithstanding that provision.

recoverable from ratepayers.[3] If, however, the premium in the price of alternative energy sources is *less than* $45/Mwh, then incurring a payment of $45/Mwh for failure to acquire the alternative energy resources would not be reasonable. In this circumstance -- that is, where the alternative resources are available for less than the $45/Mwh alternative compliance payment -- the $45/Mwh payment should not be recoverable from ratepayers.

The OCA submits that the recoverability from ratepayers of the particular alternative compliance payment must be decided on a case-by-case basis. Where the alternative compliance payment represents a fine or penalty, the OCA submits that the alternative compliance payment would not be recoverable from ratepayers. To the extent, however, that the alternative compliance payment represents the least cost method for an EDC to comply with the Act, then such payments may be recoverable.

E. Portfolio requirements of other states and regional coordination.

Other states, particularly fellow PJM member states of New Jersey and Maryland, have pursued renewable portfolio requirements. The Commission will need to ensure that its tracking and verification programs can work with other state programs and verify that the same resource is not being used to meet requirements in multiple states. It is the OCA's understanding that the PJM GATS will have this capability.

F. Development of technical standards for verification of energy efficiency and demand side management activities, and proposed depreciation schedules for alternative energy credits resulting from such measures.

Over the years, the Commission, the EDCs and PJM have done much work in the area of verifying energy efficiency and demand side management savings. Much of this work can be utilized by the Commission in implementing Act 213. The OCA would particularly note

[3] It is also the OCA's understanding that the $45/Mwh would, in essence, be in addition to the market price of traditional resources since the EDC would still have acquired traditional resources to serve its load.

the work of PJM in its non-interval metered demand side response program. PJM has developed a means to determine load reductions for non-interval metered customers in programs such as residential air conditioning load control programs. The Commission should work closely with PJM on the verification procedures.

The OCA does not propose a specific depreciation schedule for DSM and energy efficiency activities at this time, but would expect that a depreciation schedule that reflects the anticipated life-cycle of the program or the equipment utilized to implement the program would satisfy the requirements of Act 213. A depreciation schedule that is too short may not properly reflect the value of the measures, and it could result in the premature elimination of beneficial programs so that new programs, receiving new credits, could be implemented. A depreciation schedule that is too long, however, may slow the development of new programs. The OCA looks forward to more discussion of this issue in the Technical Conference.

G. Development of technical standards for net metering

The OCA will not address technical standards or meter specifications for net metering. The OCA does submit, however, that metering must be bidirectional. In other words, the EDC must be able to measure whether the distributed generation facility provided energy to the system rather than just reduced the system usage of the customer.

H. Development of technical standards for interconnection.

The Commission has recently issued an Advanced Notice of Proposed Rulemaking Regarding Small Generation Interconnection Standards and Procedures at Docket No. L-00040168. The OCA will file comments on that Rulemaking in the near future. The Commission could include any additional work on interconnection standards that is necessary into this rulemaking proceeding.

III. CONCLUSION

The OCA appreciates this opportunity to present preliminary comments on the implementation of Act 213. The OCA hopes that these Comments assist the Commission in identifying the issues related to the implementation of Act 213 and in identifying the policies, procedures and regulations that will be necessary. The OCA looks forward to making its presentation at the Technical Conference of January 19, 2005 and to participating in the discussion of the issues at the Technical Conference and thereafter.

Respectfully Submitted,

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