BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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REPLY COMMENTS
OF THE
OFFICE OF CONSUMER ADVOVATE

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## I. INTRODUCTION

On January 19, 2005, the Pennsylvania Public Utility Commission ("Commission") conducted hearings regarding the implementation of Act 213 of 2004, the Alternative Energy Portfolio Standards Act. The hearings were conducted along with the Department of Environmental Protection ("DEP"). Chairman Holland, Commissioner Thomas, Commissioner Pizzingrilli and Secretary McGinty of the DEP actively participated in the Roundtable discussion. The OCA appreciated the opportunity to provide both written and oral comments regarding the important implementation issues of Act 213. The implementation of Act 213 will have significant impacts upon consumers and should provide benefits to consumers if properly and reasonably implemented.

At the proceedings on January 19, 2005, and through a subsequent Secretarial Letter, the Commission announced that Reply Comments could be submitted by February 9, 2005. The OCA files these Reply Comments to address an issue that was raised in Comments, and at the Roundtable, that is of particular concern to consumers. That issue is the question of the ownership of the alternative energy credits associated with existing non-utility generation ("NUG") projects that are qualifying facilities ("QF") under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). 16 U.S.C. § 824a-3. Pennsylvania ratepayers are currently paying billions of dollars in costs for these QF projects under contracts that Pennsylvania EDCs were required to enter into under PURPA. These costs are being borne both as stranded costs and as the costs of generation that ratepayers continue to pay.

The OCA submits that the Commission should conclude that the alternative energy credits created under state law that are produced by existing NUG projects that have contracts with electric distribution companies ("EDC"s) pursuant to PURPA are owned by the related to this same energy production would result in a double recovery. Such a double recovery is clearly unjust and unreasonable.

## II. REPLY COMMENTS

### A. The Commission Must Make Clear That The Alternative Energy Credits Associated With Energy Delivered From Existing Non-Utility Generation Projects Under Power Purchase Agreements With EDCs Benefit The Consumers That Are Paying The Costs Of The Power Purchase Agreement.

In the Comments filed with the Commission on January 14, 2005, the York County Solid Waste and Refuse Authority ("York Authority"), a non-utility generating ("NUG") project having a power purchase agreement ("PPA") with Metropolitan Edison Company ("Met-Ed") under the requirements of PURPA, and the FirstEnergy Companies of Met-Ed, Pennsylvania Electric Company ("Penelec"), and Pennsylvania Power Company, addressed the issue of the ownership of alternative energy credits associated with existing NUG projects that are under contract with an EDC. The York Authority takes the position that the alternative energy credits are owned by the NUG. The York Authority argues that unless the PPA specifically addressed the alternative energy credit, the NUG can now sell or trade the alternative energy credit separate from the energy purchased by the EDC under PPA. In other words, as the owner, the NUG can sell or trade the alternative energy credit to whomever it pleases. York County Solid Waste And Refuse Authority Comments at 6-7. The FirstEnergy Companies take the position that the alternative energy credits belong to the purchaser of the generation under the contract, and the benefit of the alternative energy credits resulting from the purchase under the contract should flow to their customers. FirstEnergy Comments at 9-10.

The OCA submits that the FirstEnergy Companies have it right. The alternative energy credits associated with existing NUG projects with contracts under PURPA belong to the purchaser of the energy and must be used to benefit the ratepayers who have paid, and continue to pay, all costs incurred by the purchasing EDC under the contract. Ratepayers, through generation rates and stranded cost awards, are paying billions of dollars of costs incurred by EDCs under power purchase agreements with NUGS pursuant to PURPA. Alternative energy credits created under state law for these resources must be used as a credit for the benefit of ratepayers who are paying for these projects. In other words, the EDC purchaser of the energy receives the alternative energy credit toward its compliance requirements under Act 213. Any other interpretation under Act 213 would be untenable.

An alternative energy credit under Act 213 is defined as follows:

> A tradable instrument that is used to establish, verify and monitor compliance with this act. A unit of credit shall equal one megawatt hour of electricity from an alternative energy source.

Act 213, Section 2. As can be seen from the definition, the basis of the credit is the actual energy produced by the alternative energy source.[2] The energy produced by existing NUGs, which is the basis of the alternative energy credit, has been sold to the EDC through the contract that the EDC was required to enter pursuant to PURPA.

The issue of the ownership of credits established by state statutes has been considered by both the Federal Energy Regulatory Commission ("FERC") and the NJ BPU. By Order entered October 1, 2003, FERC issued a declaratory order on the issue of the ownership of renewable energy credits created by state statute. American Ref-Fuel Co., *et al.*, 105 FERC ¶61,004. FERC concluded that renewable energy credits exist outside of the confines of PURPA and thus PURPA does not address the ownership of the RECs. FERC reasoned as follows:

> As noted above, RECs are relatively recent creations of the States. Seven States have adopted Renewable Portfolio Standards that use unbundled RECs. What is relevant here is that the RECs are

[2] The OCA would note that the PJM GATS Concept Paper is consistent with this in that it envisions tracking generation attributes on a per MWh basis. The GATS system, as envisioned, is tied to the plant output. If, for example, the plant is out of service and not generating energy, there would be no attributes produced by the plant.

> created by the States. They exist outside the confines of PURPA. PURPA thus does not address the ownership of RECs. And contracts for the sales of QF capacity and energy, entered into pursuant to PURPA, likewise do not control the ownership of RECs (absent an express provision in the contract).

American Ref-Fuel, Id., Order at paragraph 23. FERC then concluded that: "***States, in creating RECs, have the power to determine who owns the REC in the initial instance, and how they may be sold or traded; it is not an issue controlled by PURPA.***" Id. (emphasis added). FERC reiterated this position in its Order Denying Rehearing entered April 15, 2004.

It is clear that the Commonwealth of Pennsylvania must make the decision regarding the ownership and transfer of the alternative energy credits under Act 213. In a recent decision on this very point, the New Jersey Board of Public Utilities concluded that, for existing NUG contracts, the renewable energy credits belong to the purchaser of the energy. The oral motion approved by the New Jersey BPU was as follows:

> And so the motion for your consideration would be for us to draft an order indicating that the Board made a determination that for these existing NUG contracts, it's not for new contracts and it's only for these finite number of contracts that were entered into ten or fifteen years ago, that the ownership of the RECs would belong to the purchaser.

Transcript of January 12, 2005 Meeting, page 4 (Docket No. EO-04080879)(attached hereto as Appendix A). The Motion was approved by a vote of 4-0. The final written order has not yet been entered.

In considering this issue, the OCA submits that there are several important points to bear in mind. Initially, it must be remembered that the statutory scheme of PURPA was to provide benefits to small power production facilities that utilized certain renewable and non-traditional resources as well as to provide benefits to small cogeneration facilities. In FERC v.

Mississippi, 456 U.S. 742, 750-751, 102 S.Ct. 2126, 72 L.Ed. 532 (1982) the United States Supreme Court observed the following:

> Section 210 of PURPA's Title II, [citation omitted], seeks to encourage the development of cogeneration and small power production facilities. Congress believed that increased use of these sources of energy would reduce the demand for traditional fossil fuels. But it also felt that two problems impeded the development of nontraditional generating facilities: (1) traditional electricity utilities were reluctant to purchase power from and to sell power to, the nontraditional facilities, and (2) the regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the nontraditional facilities and discouraged their development.

Id. at 750-751 (footnote omitted). To overcome these barriers and to encourage these facilities, Congress conferred substantial benefits on qualifying projects. The federal district court later described the purpose of PURPA and the benefits it granted:

> [T]o encourage the development of facilities that generate electricity using renewable resources and facilities engaged in cogeneration of electricity and useful heat or steam that might otherwise be wasted, [citation omitted] and to overcome the reluctance of traditional utilities to by from, and sell to, these alternative producers, ***Congress granted qualifying facilities certain benefits.*** Under PURPA, such facilities were exempted from certain regulatory controls, and they were assured a market by providing a right to interconnect with the local public utility and to receive rates, as prescribed by FERC, up to the full avoided cost of the utility.

Southern California Edison Co. v. FERC, 195 F.3d 17, 19 (D.C. Cir. 1999)(emphasis added). Under PURPA, a qualifying small power production facility is an approved cogenerator or a small facility which "produces electric energy solely by the use, as a primary energy source, of biomass, waste, renewable resources, geothermal resources, or any combination thereof." 16 U.S.C.S. §796(17)(A)(i). It is the fact that the facility produces electricity from these resources that justifies the contracting and pricing preference under PURPA. These are many of the same resources identified in Pennsylvania's Alternative Energy Portfolio Standards Act.

The entitlement to a long term contract, the entitlement to full avoided cost pricing, and the exemption from regulatory controls, were, and still are, "substantial benefits" that Congress conferred to "qualifying facilities" through PURPA. Southern California Edison, 195 F.3d at 23. The Pennsylvania Commonwealth Court, when considering issues related to PURPA, recognized the extraordinary nature of these benefits. The Commonwealth Court stated:

> In PURPA Congress conferred an extraordinary benefit on QFs in service of the overall goal of reducing the nation's dependence on unreliable energy sources. QFs may compel utilities to purchase the power they produce and at a very good price.

Armco Advanced Materials Corp v. Pa PUC, 135 Pa. Commw. 15, 34, 579 A.2d 1337, 1347 (1990)(Milesburg II). The Pennsylvania Supreme Court described the effect of PURPA as follows:

> The practical effect of PURPA is to divert potential profits from regulated electric companies whose earnings are largely based on the value of their owned facilities, to the owners of QFs.

Pennsylvania Electric Company v. Pa. PUC, 544 Pa. 475, 477-478, 677 A.2d 831, 832 (1996).

The Pennsylvania regulations implementing PURPA codified these benefits as required by PURPA. 52 Pa. Code §57.31, *et seq.* Through these regulations, EDCs in Pennsylvania were required to enter into long term contracts for the purchase of energy and capacity at full avoided cost pricing with facilities that were qualified under PURPA. It is important to again note that it was only because of the attributes of the resource used to produce the energy that the QF was entitled to the special benefits of PURPA.

By proceeding under PURPA, the generator was entitled to a long term contract that assured a revenue stream for the NUG and avoided the risks of market forces. The EDC was protected in that the Commission provided for full and current recovery of these long term contract costs from ratepayers. The customers have paid – and continue to pay – the above market costs. Through the implementation of PURPA, the risk associated with the NUG energy was shifted to ratepayers through the contracting and the cost recovery process. See, *e.g.*, West Penn Power Co. v. Pa. PUC, 150 Pa. Commw. 349, 375, 615 A.2d 951, 965 (1992)(Shannopin II)("West Penn transferred all risk to its ratepayers that if the power received under this 'take or pay' Purchase Agreement was not needed, then the burden to pay for the power would shift onto its ratepayers, not its shareholders.")

In Pennsylvania, ratepayers are paying billions of dollars in stranded costs, *i.e.*, above market costs, for NUG projects that the EDCs were required to contract with under PURPA and which were explicitly deemed recoverable as stranded cost under Pennsylvania's Electric Restructuring Act. 66 Pa.C.S. §2808(c)(1) and (2). Penelec's NUG-related stranded cost, for example, is estimated to be $918.36 million and Met-Ed's NUG-related stranded cost is estimated to be $516.7 million. Application of Metropolitan Edison Co. and Application of Pennsylvania Electric Co., Docket Nos. R-00974008 and R-00974009, Joint Settlement, Appendix E. By now asserting ownership of the alternative energy credits, however, the NUG owners seek to retain the benefits of PURPA protection but gain the benefits of market participation through the sale of alternative energy credits yet again in the new alternative energy market. The NUGs cannot have it both ways. Ratepayers should not have to pay twice for the same energy.

The alternative energy credits are inextricably linked to the energy produced and delivered from the NUG. The NUG has already received substantial benefits and preferential treatment based on the renewable attributes through the PURPA scheme of contracting and pricing, and should not receive yet additional benefits at the expense of Pennsylvania ratepayers.[3] If the NUG claims that it is selling energy to the EDC that does not contain any of the attributes that qualified it for a long term contract and avoided cost pricing under PURPA, the OCA questions whether the contracts can continue.

Through PURPA, ratepayers have paid for the attributes that qualified the project for special benefits, and they have paid for the energy and capacity from those projects. Requiring ratepayers to now pay for these attributes again as alternative energy credits would be a double count. The OCA would note that this issue is similar to the consideration of the costs of existing resources that have been transferred to an EDC's generation affiliate. See, OCA Comments of January 14, 2005 at 5-8. To require ratepayers to pay for existing resources through stranded cost awards and generation rates, and then again as alternative energy credits, is double recovery whether it be from the NUG or the EDC's own generation.

The OCA strongly urges the Commission to reach the same conclusion as the New Jersey BPU in its recent consideration of this issue – the alternative energy (renewable energy) credits belong to the EDC purchaser who must use those alternative energy credits to the benefit of its ratepayers.

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3 The OCA would note that the Pennsylvania Public Utility Code intends for benefits from alternative resources to be provided to ratepayers. For example, Section 527 requires rates to reflect savings to the utility from cogeneration. 66 Pa.C.S. §527.

## III. CONCLUSION

The OCA thanks the Commission for this opportunity to file Reply Comments on this important issue. The OCA looks forward to continuing to work with the Commission and the Department of Environmental Protection on the implementation of Act 213.

Respectfully Submitted,

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APPENDIX A

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STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

NEWARK, NEW JERSEY WEDNESDAY, JANUARY 12, 2005

BOARD AGENDA

ITEM 2B - ENERGY

Docket No. EO04080879 - In the Matter of the Ownership of Renewable Energy Certificates ("RECS") under the Electric Discount and Energy Competition Act, as it Pertains to Non-Utility Generators and the Board's Renewable Energy Portfolio.

BEFORE: PRESIDENT JEANNE M. FOX
COMMISSIONER FREDERICK F. BUTLER
COMMISSIONER CONNIE O. HUGHES
COMMISSIONER JACK ALTER

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PRESIDENT FOX: We're now out of Executive Session, Elise, you want to give us a word of that was for attorney/client privilege for all five items - -

MS. GOLDBLAT: Six. And Late Starters A and C also involve potential litigation.

PRESIDENT FOX: Okay. We'll first do 2B.

MS. WALLENSTEIN: This matter concerns the ownership of Renewable Energy Certificates under EDECA and the Board's Renewable Energy Portfolio Standard.

As you recall in August of 2004, the Board determined to open a separate proceeding to consider this issue and solicit comments and reply comments. We received extensive comments from the parties and reply comments which our office has summarized for you in a memo that we sent.

The comments were basically - - there was two sides to the argument. The generators and the QFs argued that the Renewable Energy Certificates belong to the generator, for the most part the electric utilities.

The Ratepayer Advocate and one BGS supplier who submitted comments argued that they belong to the purchasers of the power.

We discussed the - - in Executive Session the legal arguments that were raised by all the parties, the operative FERC decision that we need to consider indicates that the issue lies with the states in creating the RECs. The states have the power to determine who owns the RECs in the first instance and how they may be sold or traded. It is not an issue controlled by PURPA.

Accordingly, we recommend that the Board does have jurisdiction to make a ruling on this issue. In considering the arguments for the parties the Board's decision needs to be based on state law, state statutes and the Board's orders approving these - - these contracts and -

- and based on the discussion we had and the arguments that we analyzed, I think the consensus was that - - that the arguments made by the EDCs and the Advocate were compelling.

And so the motion for your consideration would be for us to draft an order indicating that the Board made a determination that for these existing NUG contracts, it's not for new contracts and it's only for these finite number of contracts that were entered into ten or fifteen years ago, that the ownership of the RECs would belong to the purchasers.

PRESIDENT FOX: Is there a motion?

COMMISSIONER HUGHES: So moved.

COMMISSIONER BUTLER: Second.

PRESIDENT FOX: Any discussion? I think the analysis, the legal analysis was quite good. I think we're all very much satisfied with this issue. And I think it's in the public interest.

And I think prospectively, obviously, everybody knows that RECs are worth something and clearly any half decent attorney will recommend to their clients that they put something in their contracts to that regard.

And vote?

SECRETARY IZZO: On the motion to approve the staff's recommendation.

Commissioner Butler?

COMMISSIONER BUTLER: Yes.

SECRETARY IZZO: Commissioner Hughes?

COMMISSIONER HUGHES: Yes.

SECRETARY IZZO: Commissioner Alter?

COMMISSIONER ALTER: Yes.

SECRETARY IZZO: President Fox?

PRESIDENT FOX: Yes.

(Whereupon, the recommendation was approved.)

PRESIDENT FOX: Thank you.