BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY COMMENTS ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
ON THE IMPLEMENTATION ORDER

The act of November 30, 2004 (P.L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act ("Act"), requires that increasing percentages of the electricity sold in the Commonwealth be generated from designated alternative energy sources.

By Notice dated January 7, 2005, the Pennsylvania Public Utility Commission ("PUC" or "Commission") announced a January 19, 2005, technical conference to facilitate the implementation of the Act. The Office of Small Business Advocate ("OSBA") submitted written comments prior to the conference, made an oral presentation at the conference, and subsequently filed written reply comments.

By Notice dated February 14, 2005, the Commission convened the Alternative Energy Portfolio Standards Working Group ("Working Group"). The OSBA participated in Working Group meetings on March 3, 2005; March 15, 2005; April 19, 2005; and May 18, 2005. The OSBA also submitted written comments on April 1, 2005; April 14, 2005; and May 13, 2005.

By Order entered March 25, 2005 ("Implementation Order"), the Commission invited comments on a variety of issues relating to implementation of Act 213. The

OSBA submitted written comments on May 24, 2005. Ordering Paragraph No. 1 of the Implementation Order states that reply comments are due within 30 days of the deadline for submission of initial comments. The OSBA submits the following reply comments in response to the initial comments of other parties.

Compliance Exemption Periods/Banking of Alternative Energy Credits

The Energy Association of Pennsylvania ("EAPA") and several individual electric distribution companies ("EDCs") have identified a timing issue caused by the fact that the Act's "reporting period" runs from June 1 through May 31 while the "cost recovery period" expires on December 31.[1] This timing issue creates a potential problem in calculating the volume of electricity from alternative energy sources an EDC must sell in the first year after the cost recovery period and a potential problem in determining the period during which alternative energy credits ("AECs") banked during the cost recovery period may be counted toward compliance with the Act.

Under Section 3(b) and (c) of the Act, an EDC must initially meet the requirement to sell a specified percentage of its electricity from alternative energy sources "[t]wo years after the effective date of this act [Act 213]" and must subsequently sell increased percentages, with the specific amount depending upon the number of years since that effective date. Although the Act's effective date was February 28, 2005, Section 3(d) of the Act grants an exemption to EDCs until the end of their respective cost recovery periods. Accordingly, the Commission has proposed that each EDC's initial compliance be measured by sales during the reporting period which begins on June 1 of the last calendar year of the cost recovery period and ends May 31 of the first calendar year after

[1] Under Section 2 of the Act, "cost recovery period" is defined as the longer of the period during which an EDC is recovering stranded costs or the period an EDC is otherwise subject to a generation rate plan.

the cost recovery period. However, as pointed out by Exelon Business Services Company ("Exelon"), it is unclear whether the Commission intends to determine an EDC's initial compliance by applying the annual percentage rate to the quantity of electricity sold from January 1 through May 31 or intends to require that the quantity of electricity from alternative energy sources (including AECs) in that five-month span be equal to the quantity which would otherwise be required for the entire twelve-month reporting period.

Similarly, under Section 3(e)(7) of the Act, an EDC which banks AECs during its cost recovery period may use those AECs to help satisfy compliance for only two reporting periods. The Commission has proposed that those two reporting periods include the reporting period during which the EDC's cost recovery period ends. As pointed out by EAPA, that means that banked credits may be used for compliance in only a 17-month period rather than in a 24-month period. In recognition that Section 3(e)(7) does not clearly specify when the two relevant reporting periods are to begin, the OSBA agrees with the EAPA's proposal to allow banked AECs to be used during the first two full reporting periods after the expiration of an EDC's cost recovery period.

Furthermore, in order to provide symmetry between the first reporting period for the use of banked credits and the first reporting period for measuring compliance with the Act, the OSBA recommends that initial compliance be determined on the basis of the electricity sold in the first full reporting period after the expiration of an EDC's cost recovery period.

Alternative Energy Portfolio Working Group

The EAPA has recommended that the Commission task the Working Group with developing a proposed mechanism for the automatic recovery of an EDC's costs of complying with Act 213.

Section 3(a)(3) of the Act provides that costs incurred by an EDC for the purchase of electricity from alternative energy sources and costs for the purchase of AECs shall be recovered "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 Section 2807(e)(3), an EDC "shall acquire electric energy at prevailing market prices . . . and shall recover fully all <u>reasonable</u> costs." (emphasis added) Under Section 1307(a), surcharges are intended to provide a public utility with a "just and reasonable return" on its rate base and may be revoked if rates are "unjust or unreasonable." Therefore, by linking purchases under the Act to Sections 2807 and 1307, the General Assembly set parameters for determining the allowable costs to be recovered from ratepayers. To fit within those parameters, the OSBA recommends that EDCs be required to utilize a competitive procurement process for acquiring electricity from alternative energy sources.

Significantly, the OSBA's recommendation is consistent with the Commission's proposed regulations for default service, in that proposed 52 Pa. Code §54.186(a) of those regulations would mandate that the default service provider procure <u>all</u> electricity – including electricity from alternative energy resources – through a competitive procurement process. <u>See</u> Annex A to the Order entered December 16, 2004, at Docket No. L-00040169 and Docket No. M-00041792.

Electricity generated from alternative energy sources has the potential to offset volatility in the market price of electricity. Ideally, an EDC would seek bids for a stated quantity of electricity, with a bid requirement that a specified percentage of that electricity must be provided from alternative energy sources. Potential wholesale suppliers responding to such a solicitation might then be in a position to lower their bid prices to reflect the benefits of using alternative energy sources as a hedge.

However, because the Act states that the cost of electricity from alternative energy sources is to be collected through a surcharge, it may be difficult to conduct a competitive procurement process which results in a blended price for a combination of electricity from non-alternative sources and electricity from alternative sources. The OSBA believes that there are two reasonable solutions. First, the Commission could give an EDC the option of waiving recovery of alternative energy costs under an automatic adjustment clause if the EDC acquires electricity through a competitive process at a blended price and charges that blended price for default service. Second, the Commission could require the EDC to conduct two separate competitive solicitations, one for electricity from alternative energy sources and one for electricity from other sources.

In the alternative, if the Commission does not require the use of a competitive process for procuring electricity from alternative energy sources, the OSBA recommends that the regulations include "prudence" and "least cost procurement" requirements similar to those imposed by 66 Pa. C.S. §§ 1307(f), 1317, and 1318 on the acquisition of natural gas.

Furthermore, regardless of whether the Commission requires a competitive procurement process or establishes a review process similar to the one applicable to natural gas, the OSBA recommends that the proceeds from the sale of AECs created at ratepayer expense be offset against any charges to ratepayers for the purchase of AECs. Such an approach would be consistent with the procedure under Section 1307(f) for reconciliation of gas commodity costs and would permit consumers to challenge the AEC sale price if it appears that the EDC is engaged in a bargain sale of AECs at the expense of the ratepayers who paid for the purchase of those AECs.

Credits for Non-Utility Generation

Integrated Waste Services Association ("IWSA"); The Harrisburg Authority ("Harrisburg"); and Pennsylvania Renewable Resources, Associates ("PRRA"), submitted similar comments regarding ownership of any AECs which may be created as a result of electricity produced by a non-utility generating facility ("NUG"). In essence, their position is that any such AECs are owned by the NUG unless otherwise provided in the power purchase agreement ("PPA") between the NUG which generates the electricity and the EDC which purchases that electricity.

The question of ownership of these AECs is also pending before the Commission in Petition For A Declaratory Order Regarding the Ownership of Alternative Energy Credits and any Environmental Attributes Associated with Non-Utility Generation Facilities Under Contract to Pennsylvania Electric Company and Metropolitan Edison Company, Docket No. P-00052149. The OSBA is a party to that other proceeding. However, to avoid any possible waiver of its right to comment as part of the process for developing Act 213 regulations, the OSBA sets forth the following as a brief summary of its arguments on the ownership question.

Absent some explicit language in the PPA to the contrary, an existing NUG does not have a property interest in AECs because AECs did not exist when the PPA was entered. Specifically, the General Assembly and the Governor had discretion as to whether to enact Act 213 and as to whether to include NUG energy sources within the definition of "alternative energy sources." In fact, Act 213's definition of "alternative energy sources" to include electricity from NUGs is significantly broader than the definition of "renewable energy sources" used in other states. Therefore, the critical question in determining ownership of the NUG-related AECs is not what the Public Utility Regulatory Policies Act of 1978 ("PURPA") says or what the PPA says. Instead, the key question is what Act 213 itself says.

The purpose of Act 213 is to require Pennsylvania EDCs to obtain from alternative energy sources a designated percentage of the electricity they sell. Section 3(e)(1) of the Act requires the Commission to "establish an alternative energy credits program." The Act contemplates that an EDC which is short of the required percentage of electricity from alternative energy sources will be able to buy credits from another EDC which has sold more than the required percentage of electricity from alternative energy sources. The effect will be to assure that the required quantity of alternative energy sold in Pennsylvania is met by all EDCs in the aggregate.

Section 2 of the Act defines "alternative energy sources" as including "<u>existing</u> and new sources." Therefore, Act 213 contemplated the creation of credits applicable to <u>existing</u> NUGs.

Section 3(e)(2)(i) provides that an alternative energy credits program administrator, selected by the Commission, will have the power and duty to create and administer an AEC program, including a process for "determining the manner credits can be created, accounted for, transferred and retired." The administrator's actions will be limited to the exercise of powers and duties assigned by the Commission's regulations. Therefore, the General Assembly has delegated to the Commission the power and duty to determine, through regulations, who owns the AECs associated with each type of alternative energy source, including credits associated with electricity produced by a NUG.

In carrying out the legislature's directive, there are both legal and policy reasons why the Commission should specify that AECs associated with the electricity provided under an existing PPA belong to the EDC and not to the NUG.

First, the definition of "alternative energy credit" in Section 2 of the Act specifies that "[a] unit of credit shall equal one megawatt hour of electricity from an alternative energy source." In order to sell an AEC, a NUG must be able to supply the electricity on which that AEC is based. A PPA typically requires an EDC to take all of the NUG's output. Therefore, because the NUG is not able to supply the electricity to anyone other than that EDC, the NUG does not have any credits to sell.

Second, the Commonwealth Court concluded that, in restructuring, "GPU Energy folded its NUG contract costs into its rate base but certain NUG contract costs that were above market rates were considered stranded costs." (emphasis added) ARIPPA v. Pennsylvania Public Utility Commission, 792 A. 2d 636, 642, fn. 5 (Pa. Cmwlth. 2002). Section 2808(c)(1) of 66 Pa. C.S. requires the Commission to allow each EDC to recover stranded costs through the Competitive Transition Charge ("CTC"), including those "cost obligations under contracts with nonutility generating projects that have received a commission order." Therefore, ratepayers have been forced to pay an above-market price for NUG electricity and to do so <u>only</u> because the NUG generating that electricity has the attributes to be deemed a "qualifying facility" under PURPA.

If a NUG is permitted to sell those attributes as AECs to an entity other than the EDC which is obligated to buy the NUG's electricity, the NUG's electricity will not count for purposes of meeting that EDC's alternative energy requirements under Act 213. As a result, that EDC's customers will be forced to pay for "replacement" AECs <u>and</u> continue to pay for the NUG's electricity at an above-market price. The NUG's earnings from the sale of the AECs will amount to unjust enrichment of the NUG at the expense of the EDC's ratepayers.

In view of the foregoing, the OSBA recommends that the regulations specify that AECs attributable to electricity supplied under an existing PPA belong to the EDC which is required to pay for that electricity. The OSBA further recommends that the regulations specify that if the EDC sells the AECs, the proceeds of that sale must be flowed through to the selling EDC's ratepayers. In the alternative, if the Commission determines that the AECs belong to the NUG and not to the EDC, the OSBA recommends that the regulations specify that the NUG's earnings from selling the credits must be offset against the amount the EDC would otherwise be required to pay the NUG for the NUG's electricity.

WHEREFORE, the OSBA respectfully requests that the Commission implement the Act in a manner consistent with the OSBA's initial comments and with the foregoing reply comments.

Respectfully submitted,

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Dated: June 23, 2005