State of Florida

Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: September 9, 2008

TO: Ann Cole, Commission Clerk - PSC, Office of Commission Clerk

FROM: Karen W. Webb, Economic Analyst, Office of Strategic Analysis and Governmental Affairs

RE: Docket file for Docket No. 080503-E1 - Establishment of rule on Renewable Portfolio Standard

Please place the attached letter from the Florida Renewable Energy Producers Association in the docket file.

KWW
Attachment

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Draft Comments on the PSC Strawman Draft Rule
Prepared August 19, 2008

The PSC Strawman Draft Rule ("Strawman proposal") has some positive provisions, but in total, it would establish a renewable energy portfolio standard ("RPS") that is destined for failure. Other policy considerations aside, the PSC should focus on establishing a RPS that will be successful and achieve the policy goals established by the Florida Legislature, the foremost of which is the increased development of renewable energy in Florida. Unfortunately, the Strawman proposal would create a system that cannot succeed and will not result in the increased development and use of renewable energy in Florida.

If the Florida RPS fails it will reflect poorly on the State of Florida, its energy regulators, and its energy industry. Regulated energy markets throughout the nation and the world have successfully established RPS regulatory systems. Therefore, there are models of successful RPS regulatory systems from which to draw from. If the Florida RPS fails it will be the result of poor policy choices, not a failure of the market or the industry. For an RPS to succeed it must promote competition, eliminate barriers to market entry, and end the ability of investor owned utilities to dictate the terms for entry into the power production market.

The Strawman proposal makes contrary policy choices by establishing more barriers to entry into the market and giving more control to investor owned utilities. As the Strawman proposal is written, any renewable energy producer that desires to sell renewable energy credits ("RECs") would be required to enter into a purchase power agreement with an investor owned utility. This agreement would likely be a standard offer contract of the type approved recently by the PSC, which mandates energy producers give the investor owned utility a right of first refusal to purchase the RECs. This right of first refusal will effectively prohibit the renewable energy producer from selling its RECs on a national or international open market. But if the power producer sells RECs on the Florida market contemplated by the Strawman proposal, the exchange will be established and managed by the investor owned utilities.

Will this system create vibrant and robust renewable energy market in Florida? No of course not. It is an obvious recipe for failure.

1. RPS implementation schedule

The proposed schedule essentially postpones meaningful increase in development of renewable energy until 2025 and does not require the 20% goal established by Governor Crist until 2050. Governor Crist announced a goal of 20% by 2020 in

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Executive Order 07-127. The goals proposed in the Strawman proposal effectively ignore the Governor's goal by postponing any meaningful RPS until after 2020. We support meeting the Governor's goal of 20% by 2020 by using the following schedule:

By January 1, 2010: 3 percent of the prior year's retail sales
By January 1, 2015: 8 percent of the prior year's retail sales
By January 1, 2017: 15 percent of the prior year's retail sales
By January 1, 2020: 20 percent of the prior year's retail sales

This schedule reflects a modest increase from present levels of renewable energy production by 1% by 2010, and a very significant increases running up to the 2020 goal.

2. RPS Definition of Renewable Energy

The Strawman proposal correctly rejected efforts to include nuclear power within the definition of renewable energy. The fuel stock for nuclear power is uranium derived from a non-renewable mineral resource that is extracted though non-sustainable mining practices. Nuclear power is not generated from renewable fuel source, and cannot in any sense of the term be considered "renewable energy." If the PSC attempted to include nuclear power in the RPS it would be acting outside of it legislatively delegated authority in a manner that is by definition arbitrary and capricious.

The Strawman proposal correctly rejected efforts to exclude biomass from the definition of renewable energy. Biomass is a classic renewable energy source that does not rely on a finite mineral resource, such as coal, oil, gas, or uranium. The PSC must include biomass, including combustion of municipal solid waste, in the final rule.

As an organization, we have never overtly supported differentiation of renewable energy into two tiers that are treated differently nor have we publicly opposed the idea. With that said, If the PSC intend on giving special treatment to solar and wind power, we believe option III is the better choice. We believe this approach is better than a permanent, mandatory percentage set aside for two reasons: (1) option III will give utilities and renewable energy producers more flexibility to respond to market forces, and (2) option III will not create a "failure" of the RPS system if wind and solar are not available in sufficient quantities to meet the RPS set aside in options I or II. In addition, picking a set aside of 25% may be considered to be arbitrary under the Florida Administrative Procedures Act. We are not aware of any empirical evidence that would support selecting a 25% set aside, instead of 20% or 30%.

3. Compliance and Enforcement:

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The biggest problem with the Strawman proposal is that it contains no meaningful penalties for non-compliance. We believe that fines must be assessed that are sufficient to make the cost of non-compliance outweigh the cost of compliance. In addition, the fines assessed should go to support development of renewable energy. The PSC clearly has authority to assess fines for non-compliance and authority to reduce an investor owned utility's rate of return as a sanction for significant non-compliance. We would suggest the following system of fines and sanctions for non-compliance.

The PSC should establish automatic assessment of a fine for each REC below the required level, assessed for each and every day from the date compliance is required until the date the utility files evidence of compliance. These fines must not be recoverable costs that can be passed on to rate payers, or they will provide no incentive for compliance. The PSC should set this fine based on the maximum fine authorized by Florida law. At a minimum, the PSC should set an automatic fine per day per REC of $5,000, as provided in Section 350.127, Florida Statutes. While this fine may seem like a significant incentive for compliance, it may be significantly less than the cost of compliance.

If a utility completely shirks its obligations under the RPS, additional incentives will be required to motivate compliance. Accordingly, an automatic reduction of a utility's authorized rate of return, in addition to the fines described above, should be imposed for significant non-compliance:

Non-compliance level	Reduction in authorized rate of return
0.5 – 0.75 of RPS goal:	0.25% reduction
0.25 – 0.499 of RPS goal:	0.5% reduction
less than 0.25 of RPS goal:	1% reduction

4. The Cost Caps in the Strawman are Arbitrary and Indefensible

The Strawman would effectively establish two cost caps: (A) the cost of RECs and renewable energy cannot exceed 1% of the prior year retail sales, and (B) the cost of RECs are limited to the equivalent of $16/ton of CO2. These cost caps appear to be an attempt by the PSC staff to define what is "cost prohibitive" under HB 7135. Unfortunately, both of these caps are arbitrary and do not appear to be based on any objective empirical evidence or sound public policy.

The PSC has an obligation to establish an implementable definition of the Legislative term "cost prohibitive" that has a basis in reality and is grounded in empirical evidence. The PSC has not demonstrated that exceeding either of these caps would have a deleterious effect on the power industry or rate payers. For the PSC to determine that

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costs exceeding these caps are "cost prohibitive" without any rational basis is the definition of arbitrary.

Moreover, the PSC has an obligation to establish a RPS that is practicably implementable and creates a structure to support successful compliance with the RPS and increased development of renewable energy. These caps will cause the RPS to fail, transparently undermining the policy direction of the Florida Legislature. These proposed caps will effectively define meaningful development of renewable energy as "cost prohibitive."

A. 1% Rate Cap: It is unreasonable and indefensible to establish an RPS cost cap of 1% of prior year retail sales for *both increased renewable energy costs and RECs.* Common sense dictates that the cost of simply purchasing renewable energy will exceed 1% of retail sales before a goal of 20% renewable energy production is achieved. Limiting total cost of renewable energy (both increased power purchase costs and RECs) to 1% of retail sales will guarantee non-compliance and failure of the RPS.

B. REC Cap of $16/ton of CO2 Equivalent: In addition to the 1% total cost cap, the Strawman proposal suggests that there will also be a cap on the cost of individual RECs equal to $16/ton of CO2. This cost cap is speculative, arbitrary, and not supported by any objective empirical evidence. It is not clear from the rule how a carbon standard would be measured – i.e., against what baseline. However, even if implementation of the proposed $16/ton of CO2 cap was clarified, is not a defensible proxy for the cost of carbon emissions. The market value of carbon emissions will vary over time. In fact, most measures of the value of carbon reductions are well in excess of $16/ton of CO2. We do not support a REC cost cap tied to carbon reductions, but if the PSC were to implement such a policy, establishment of a value in rule in 2008 that could still apply in 2025 or 2050 would be arbitrary and indefensible. Any valuation of carbon reductions must be market driven and contain some type of escalation clause that will allow the carbon valuation to change as the market changes. Putting an value in rule, with a statement that it will be updated is not sufficient.

5. The Strawman Illegally Continues The Avoided Cost Standard

In HB 7135 the Florida Legislature specifically superseded the historic "utilities avoided cost" standard. See Section 366.92(3) (b) (1), Florida Statutes. Yet the Strawman proposal illegally continues this ill-advised policy that virtually prohibits cost-effective development of renewable energy. The PSC- approved Standard Offer Contracts of the major investor owned utilities also contain payments based on avoided cost.

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It appears that the PSC believes it is permissible to continue to require avoided cost for purchase of power, apparently allowing any additional cost recovery to occur through the sale of RECs. However, by capping the price of RECs at $16/ton of CO2 the PSC is severely limiting the ability of renewable energy producers to achieve significant cost recovery above avoided cost. Moreover, this approach ignores the Legislature's mandate to provide for full cost recovery for many sources of renewable energy. The PSC must accept the Florida Legislature's policy decision to jettison the avoided cost model and develop new models for renewable energy cost recovery that will promote development of a robust and competitive renewable energy market in Florida.

6. The Strawman is Anti-Competitive and Makes Investor Owned Utilities the Gatekeepers of the Renewable Energy Market

The Strawman proposal limits REC's to only power sold on an energy and capacity basis in a purchase power agreement with an investor owned utility, presumably based on avoided cost. This anti-competitive policy makes the investor owned utilities the gatekeeper of the market, thereby ensuring market failure. Moreover, this policy does four things that directly undermine the RPS and development of renewable energy:

A. It ensures that all renewable energy sold in Florida will be sold at avoided-cost.

B. It prohibits the renewable energy producer from taking advantage of the spot energy market.

C. It effectively requires that the renewable energy producer to sell power under the investor owned utilities' standard offer contracts. This will artificially limit the Florida renewable energy market and will allow utilities to impose conditions on REC's that will prevent a robust market for RECs. The standard offer contracts already require the renewable energy producer to give the purchasing utility a right of first refusal on all RECs. This type of restriction will limit the ability of Florida renewable energy providers to participate in REC exchanges and national markets, thereby allowing Florida investor owned utilities to unilaterally set the price for RECs.

D. It prohibits compliance with the RPS through distributed power generation, including residential and commercial active and passive solar power generation, wind and other sources of distributed, or otherwise decentralized, power generation.

The RPS cannot be successful if these anti-competitive provisions are included in the final rule. For renewable energy production to thrive in Florida, renewable energy producers must have access to a competitive market where they have the flexibility to

evaluate various business models and select the one that works best for their venture. At a minimum, renewable energy producers must have the option of selling as available energy on the open market. Many renewable energy producers may chose to enter into energy and capacity contracts, but the market cannot function effectively if that is their only option.

7. The PSC Cannot Delegate to Investor Owned Utilities the Legislative Mandate to Establish an REC Exchange

The Strawman proposal appears to forget that there are legal limitations on the PSC's discretion. The proposal that PSC delegate to investor owned utilities the authority to establish and maintain the REC market is not defensible as an energy policy or regulatory mechanism. Allowing the primary market actors to establish the REC exchange will allow the investor owned utilities to capture the REC market and continue to avoid meaningful development of renewable energy in Florida.

Not all Florida investor owned utilities have been hostile to development of renewable energy in Florida, but most have. If the PSC is determined to thwart the Florida Legislature's direction to establish an effective RPS and REC market, delegating the REC market to investor owned utilities is a sure way to do it. The PSC should accept its legislative mandate to establish an effective REC market, and establish an independent REC exchange that can operate without direct capture and coercion by investor owned utilities.