Florida Crystals Initial Comments on the August 13, 2008 Draft Rule

Implementing a Florida RPS

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Introduction

The RPS only recently became law with Governor Crist's signing of HB 7135. However, it is important to understand the history. In 2007, Governor Crist vetoed HB 7123, citing its weak progress on renewable energy and greenhouse gas reduction targets. Governor Crist then set the state on a new path, signing Executive Order 07-127 requiring the PSC to adopt a renewable portfolio standard of 20% by 2020. This Executive Order was codified by the Legislature in 2008 with the passage of HB 7135, which gave the PSC express authority to enact an RPS. In 2008, the Legislature sent a strong and unanimous signal that Florida would become a leader in the southeast on renewable energy, and that previous attempts by various interest groups to kill the RPS would not prevail. The Legislature built the framework of the RPS, but left the more prescriptive items to the discretion of the PSC. On numerous occasions, the Commission was cited as the proper body to carefully use its skill and professional expertise to make an RPS workable and meaningful. Notwithstanding the strong gubernatorial support, strong legislative support and strong public support for an RPS, the recently released Draft Rule undermines the entire concept of an RPS and the development of renewable energy in Florida.

1. ***Using avoided cost***. The Proposal is grounded on the "utilities avoided cost" standard. Applying the "avoided cost" standard is explicitly contrary to the legislative intent of HB 7135 and a sure recipe for failure of the RPS policy. Section 366.92(3) (b) (1) states…in the event of any conflict, this subparagraph shall supersede s. 366.91(3) and (4) [Note: these sections refer to the avoided cost standard]".

    a. The Proposal recommends a strict separation of energy and RECs "to allow payments for renewable resources above avoided costs". See page 5, REC Compliance paragraph of the Summary of Draft Rule. The clear intent is to apply the avoided cost mechanism to the power sales component of the transaction.

    b. The Legislature explicitly recognized that the avoided cost mechanism is not the appropriate methodology to evaluate renewable energy projects. This mechanism forces any seller of power to conform to the cost structure, operating characteristics, and timing of the utilities avoided cost. Indeed, under the avoided cost mechanism, the seller is paid the lower of the avoided unit energy costs or the system marginal energy cost. Therefore, the seller of power is competing not only against a single unit

but against the entire utility power system. For example, if the avoided unit for a given Florida utility is a "low capital/high energy cost" combustion turbine (which has frequently been the case in recent years) then the capital cost component is based on the investment cost of a CT, the theoretical availability rate of the CT (even though a CT never actually operates at the stated rate), and the energy cost of the CT, only when the CT would have operated - which is normally only a few hundred hours a year. The vast majority of the hours, the energy rate paid to the seller are the marginal energy cost of the system. Under this system, it is literally impossible for any renewable power producer to compete. The past fifteen years have amply demonstrated that the application of avoided cost translates into no new renewable energy production.

c. The mechanism applied to determine the cost reasonableness of a particular renewable project or contract should be based on the costs and operating characteristics of such renewable technology. Certainly there is enough reference data available for stakeholders to reasonably determine whether a given economic structure is reasonable or not. We advocate a renewable market is open to all participants. Competition will marginally bring cost and instill price discipline. But this tie to "avoided cost" in the draft rule should be stricken and replaced with a reasonable mechanism.

2. ***Must sell RECs separately to comply.*** The only form of purchase and sale transaction under the Proposal is to sell the power and the RECs separately. As explained above, this structure is a pre-requisite for the enforcement of the avoided cost methodology. The power sales component of the transaction would be subject to the avoided cost standard and the RECs would be subject to a separate price cap. This requirement should be rejected because it establishes an artificial and arbitrary price cap on the transaction and, in addition, makes it practically impossible to predict the price of RECs in future years. The only logic for a "RECs only" structure is to enforce the avoided cost mechanism. This structure hinders rather than facilitates transactions and therefore the development of Florida renewable. The parties should have the option of selling and buying a bundled product or an unbundled product and the option of establishing fixed prices or pricing formulas over relatively long terms, e.g. ten or twenty years. Indeed, one of the real advantages of renewable resources is that they offer greater price stability than fossil resources. The use of a "moving target" price cap on RECs virtually denies long term transactions and thereby the ability to finance renewable resources.

a. The Proposal does not explain how the REC price mechanism would operate under long term contracts. To the extent the price of RECs are adjusted to unknown levels on a regular basis (monthly, annually), it would be very risky, if not impossible, to finance any project over a long term horizon, e.g. twenty years. By contrast, the sale of a bundled product simplifies long term transactions and promotes price predictability which is a keystone for financing of a project. It also results in greater price

stability for the consumer. In sum, forced unbundling forces risks and uncertainties onto renewable power developers that any reasonable investor would simply not accept.

b. The argument that forced unbundling is necessary or facilitates compliance is spurious at best. Compliance can easily be tracked whether RECs are sold bundled or unbundled. There is simply no logic or basis to state that compliance is not possible or hampered by bundling. This is yet another proposal that would undermine renewable energy development in Florida.

3. ***Proposed caps.*** There is a need for a reasonable safeguard system to assure that the implementation of the RPS is not cost prohibitive, as set forth in Section 366.92(3) (b) (2). The issues are: (I) what is cost prohibitive and (ii) what is the appropriate mechanism to provide this safeguard.

a. The Proposal recommends two separate and independent caps: $16/ton of CO2 and 1% rate cap. The proposed $16/ton of CO2 is not a good proxy for the cost of carbon emissions. The Proposal explains that the $16/ton figure tracks the value used in a recent determination of need proceeding. The most representative (as well as the largest and the most liquid) market in the world for the value of carbon emissions under a mandatory compliance scheme is the European Climate Exchange. In June of 2008, the value of one metric ton of carbon emissions in the ECX was $43. The average value for the past twelve months is $33 per metric ton. As explained in this document, the price of RECs should not be a cap on the price of renewable energy. However, to the extent that the value of RECs is used as a reference or benchmark price then the price which should be used is the ECX price, not $16/ton. The proposed caps will be a very restrictive barrier to the development of renewable energy in Florida.

b. The 1% rate cap is unreasonably restrictive on two counts. First, common sense. As of August, 2008, renewable energy has not cost the Florida ratepayer a single penny. It is disingenuous to argue that a 1% move is "prohibitive" when over the past two years Florida ratepayers have been subjected to massive rate increases, fossil fuel adjustment charges and advanced cost recovery for very expensive nuclear projects that are at least ten years away from producing a single kilowatt of electricity. Second, fairness and equity. Since 2005, average residential rates in Florida have increased by more than 25%, and continue this trend. In light of these rate increases to Florida consumers, which presumably have been deemed reasonable and prudent, <u>it is unconscionable to argue that a 1% increase in rates is cost prohibitive</u>. The only rational explanation for a 1% cost cap is that the proponents of this draft rule are not interested in promoting the development of renewable resources in Florida.

c. Chapter 366.92 (1) recently re-enacted in HB 7135, provides specific legislative intent that Florida's renewable policy should "protect the economic viability of…existing renewable energy facilities", promote "fuel diversity", and "encourage investment within the state." When reading this, it is clear the Legislature wishes the PSC to consider multiple benefits to the RPS, including the recurring theme of economic development, energy security and energy independence in HB 7135. However, the draft rule virtually ignores these important objectives in developing the mechanisms for approval and proxies for the value of renewable resources. There is barely a mention of these important goals. The policy basis used to explain the numerical RPS targets and the value of RECs is solely reduction in GHG emissions. Certainly, the reduction in GHG emissions is a very worthy (and complementary) goal, however, it is unfair and inappropriate to disregard the economic development and fuel diversity contributions of an RPS.

4. ***An alternative safeguard mechanism.***

a. Some form of enforcement mechanism needs to be an integral part of the RPS, otherwise, utilities can simply make token efforts to meet the targets without any adverse consequences for noncompliance. Section 366.92 (3) (b) (2) states that the rule "shall provide for appropriate compliance measures" and thereby grants the Commission the authority to include enforcement mechanisms, such as an alternative compliance payment (ACP). Staff's refusal to list a single non-compliance option to be considered by the Commission in the event a utility fails to comply with the law represents a recurring undertone of hostility against the RPS.

b. Any ACP should be based on the value of renewable resources (environmental, economic development, and fuel diversity) plus a deterrent value to ensure that the utilities comply. The ECX establishes a value for carbon emissions. Studies of the economic development benefits of biomass resources establish the incremental value of biomass resources relative to conventional fossil fueled generation. In addition, renewable resources would diversify the fuel mix in Florida. There are mathematical models which quantify the value of different levels of volatility. Using these guideposts, an aggregate value of renewable resources should be determined, (Value X).

c. In the event of noncompliance, utilities should be subject to a payment of at least (Value X) per MWH of shortfall from the RPS target.

d. The payment for noncompliance should be a "below the line", charge to equity earnings, not another expense recoverable from the ratepayers.

e. The funds from noncompliance payments should be allocated according to options deemed statutorily authorized by the Commission and include such options, included but not limited to:

i. A refund to ratepayers as a credit in the fuel adjustment clause.

ii. A Contribution to a Public Benefits Fund dedicated to support and promote Florida renewable resources.

iii. A refund to ratepayers as a credit to other rate increases experienced the last twenty-four months.

f. There should be a mechanism which allows the utilities to petition for a compliance waiver if compliance is not feasible or cost prohibitive (i.e. the cost of compliance exceeds the ACP).

5. ***Proposed targets.*** The proposed targets are timid at best and contrary to the targets set forth in Executive Order 07-127.

a. In 2007, the Governor called for 20% renewable energy by 2020. The Governor has held two Summits on Global Climate Change, one Trade Mission to Europe on Climate Change and has spoken time after time about developing renewable energy in Florida. Under this proposed rule, the Governor would be over ninety years old by the time his goals are achieved, even if then. States around the country are setting aggressive renewable energy standards. In 2008, the Legislature paved the way for Florida to be a renewable energy leader in the Southeast. If the PSC doesn't set a more aggressive portfolio standard, the intent of the Legislature, the Governor and renewable energy advocates will be undermined.

b. The rationale offered by the Proposal for setting targets is shortsighted. The Proposal states, "The standards are to be based on an analysis of the technical and economic potential for Florida renewable resources". Certainly, this is an important consideration in defining the standard. However, the Proposal fails to mention any other objective or consideration in setting such target. In a broad sense, the purpose of the RPS is to establish a market system which facilitates and promotes the growth of Florida renewable resources. In addition, the Legislature explicitly states that the RPS should encourage investment in Florida, diversify the fuel mix, and lessen dependence on oil and natural gas. The Proposal is surprisingly silent on all of these important legislative objectives. One can only conclude that these objectives were ignored in the process of defining the numerical standards in the Proposal. The RPS targets should be an opportunity for growth, not a constraint.

6. ***Power purchase agreement is a pre-requisite.*** The Proposal would require non-utility producers to provide *capacity and energy under a power purchase agreement* to a Florida electric utility as an absolute requirement to participate in the RPS markets. This requirement represents yet another inexplicable and unfair barrier to entry. Any energy produced by a qualifying Florida power producer and delivered to the Florida grid should be eligible for participation in the Florida RPS, regardless of whether the delivery is pursuant to the COG-1 tariff, or short term transactions under enabling agreements, such as the EEI Master Power Purchase and Sale Agreement. Moreover, there should be no requirement for delivery of "capacity and energy". The requirement to deliver capacity in the traditional sense would exclude most wind and solar resources from consideration and would also exclude many short-term transactions which are based on energy, not capacity.

7. ***Cost recovery.*** The Proposal would allow cost recovery of power purchase agreements only through normal ratemaking procedures (i.e. presumably in rate case proceedings only). Only RECs could be recovered through the Environmental Cost Recovery clause, which allows prompt and precise recovery of the costs associated with the purchase of RECs. This requirement in the draft rule would be yet another barrier to the development of renewable power in Florida and should be stricken. Even today, the cost of power purchase agreements can be recovered by utilities through the fuel adjustment mechanism. To replace the fuel adjustment recovery mechanism with a system which may delay cost recovery until a new rate case is filed, would serve as a tremendous disincentive to enter into power purchase agreements and thereby present another barrier to the development of renewable energy in Florida.

8. ***Solar and wind set-asides.*** The Proposal recommends either set asides or multipliers for solar and wind technologies (Tier I). Florida Crystals believes all renewable technologies should play a role in accomplishing the objectives set forth by the Legislature. However, this set-aside structure created in the strawman rule may yet another barrier to renewable energy development.

    a. Use of the term "emitters" describing Tier II, misleads on the scientific reality of greenhouse gas reductions. As has been submitted to staff, it is a scientific fact that biomass energy production combusts and releases the exact amount of CO2 as is absorbed during the photosynthesis process that grows the fuel. Additionally, the EPA has recognized additional methane offsets when woodwaste is diverted from landfills into energy production. (Methane is 18 times more GHG potent than CO2). This differentiation needs more review to ensure a fair comparison between technologies and GHG benefits.

    b. To the extent that Tier I technologies are singled out for preferential treatment then the applicable safeguard system to assure that costs are not prohibitive should apply separately to Tier I and Tier II facilities, not in the aggregate. For example, if 25% of the RPS targets are set aside for

Tier I technologies then such Tier I technologies should be subject to a cost impact equal to 25% of any rate cap. Otherwise, there is a high risk that Tier I technologies would use a disproportionate share of the rate cap.

c. It is important to understand that IOUs are granted cost recovery. Therefore, there is little, if any incentive for utilities to control costs of these projects. They may choose to procure or develop expensive, unproven technologies that will provide their ratepayers little value at a high cost.

d. The draft rule provides no preference to or incentives for baseload generation from renewable resources. Obviously, baseload renewables provide the necessary electricity to maximize offset of traditional fossil fuel based generation. The draft rule should contain at least some incentive built into the rule to encourage baseload renewable generation.

Conclusion

Florida Crystals owns and operates North America's largest biomass renewable energy facility located in Palm Beach County. The expansion of Florida Crystals operations and expansion of production of renewable energy in Florida is directly linked to the Public Service Commission's promulgation of an effective RPS and wholesale changes to the current regulatory scheme in Florida.

Florida has never had a real policy to promote renewable energy. In fact, the established PSC rules and regulatory climate have trampled the development of renewable energy. The draft "strawman" rule isn't a substantial departure from the previously flawed policies. The draft contains minimal goals for renewables, maximum restraints of renewables and barriers to growing the renewable market. It seems to contains a recurring theme of suspicion of the concept of the RPS we believe the Governor Crist and the Legislature envisioned. If this rule, as drafted, were adopted and became law, we believe it would result in limited to no growth in renewable energy in Florida. The governor was bold. The Legislature was bold. The jury is out on the PSC.

The Public Service Commission, with the support of the Governor and Legislature, has the opportunity to make a bold statement about the future of renewable energy in Florida. The Commission should embrace meaningful renewable energy policy with an eye on environmental benefits, reliability, affordability, energy independence, energy security and economic development. Florida Crystals Corporation appreciates the opportunity to respond to the "strawman" rule and welcomes the open dialogue with the Commission to foster greater understanding of these issues. We are willing to be a partner in the effort to grow the renewable energy market in Florida, and are hopeful that staff and will revisit and rewrite a draft rule that will address these concerns. We welcome your questions and comments.