

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Establishment of rule on
Renewable portfolio standard.

DOCKET NO. 080503-EI

December 8, 2008

OPC'S COMMENTS ON DECEMBER WORKSHOP

Pursuant to the directive of the Commissioners at the conclusion of the workshop held on December 3, 2008, the Office of Public Counsel ("OPC") offers its post-workshop comments.

INTRODUCTION

The consideration of the standard that should govern the electric utilities' renewable energy portfolio choices involves competing interests.

The environmental stakeholders' objective is to maximize the reductions of greenhouse gases that can be achieved by generating electricity with renewable resources. The more money that the Commission directs the utilities to spend on measures that reduce greenhouse gases, the more greatly they advance their goal.

The producers and vendors of renewable technologies wish to market their wares, engage in the business of generating electricity with renewable sources, and earn a profit. The greater the amount of money the Commission directs the utilities to expend on renewable energy above and beyond the utility's "avoided cost", the greater amount of "headroom" that is available to turn into more projects and greater profits.

Central to the regulated utilities' agenda is the ability to collect from customers all of the costs associated with meeting the renewable portfolio standard established by the Commission. In addition, they encourage the Commission to provide them with "incentives" to participate more aggressively.

That brings us to the utilities' customers, who will bear the costs of complying with the standards set by the rule. OPC is confident that most, if not all, customers support the concept of utilizing technologies that will reduce the adverse impact of generating electricity on the environment—including the impacts on climate change. However, they are concerned with how much of the renewable initiative they can afford to fund through the rates they pay.

During this proceeding, some participants have attempted to downplay the significance of this concern. During one workshop, a participant objected to Staff's proposal to include the term "affordability" in the language of the rule. During another, a participant characterized the consideration of the impact of the standard on bills and the customers' ability to pay as "expanding the dialogue" beyond the scope he felt was germane. However, the statute that governs the Commission's activity explicitly directs the Commission to consider that at some point renewable energy may become prohibitively expensive.

Given the disparities among the costs of the various renewable technologies that are available, when adopting a standard the Commission must first make a fundamental choice: Should the rule have as its purpose the generation of the most renewable energy at the lowest possible cost?

Or, should the rule ensure that the portfolios will incorporate some of each technology, regardless of cost differentials? The Commission's answer will affect directly the quantity of renewable energy that is realized with customers' dollars.

While the question involves significant policy considerations, the mathematical relationships are straightforward. Direct the utilities to allow the renewable producers to compete head-to-head and choose the most economical sources, and the result will be the most energy for the available dollars. Impose on the utilities something of a quota for each technology, regardless of relative costs, and the average cost per unit of renewable energy will increase, while the total that can be purchased with the same dollar amount will decrease. A decrease in the amount of renewable energy that can be purchased or produced with a given number of dollars means necessarily that either the milestone for meeting a percentage-of-total-energy standard must be pushed out farther in time relative to the "head-to-head" approach, or the Commission must increase the total dollars to be spent on renewable relative to the most competitive approach to meet the same standard.

OPC submits the most appropriate answer to this threshold question is apparent when one looks at the "bigger picture." While the legislation that the Commission is implementing refers to the possibility of favoring certain technologies within the standard, this language is permissive, not mandatory. More basic forces are at work. Ratepayers presently are under severe financial distress. Their electric bills are being increased by volatile fuel costs, rising costs of complying with environmental regulations, the costs of conservation programs, and, more recently, the huge costs of funding, in advance, the construction of massively expensive nuclear

projects. OPC submits these considerations, plus the deteriorating economy, compel the view that the primary thrust of the rule should be to accomplish the portfolio standard through the most economical and cost-effective means possible.¹ OPC's comments with respect to the form the rule should take have been and will continue to be shaped by that view. OPC favors a rule that (1) includes no "carve-outs" or "set-asides" that would impede the ability of the utilities to meet the portfolio standard using the most economical mix of renewable sources available to them; (2) calls for competitive Requests For Proposals as the means most likely to produce that most cost-effective mix; (3) limits the amount the utilities are permitted to spend on renewable energy credits to 1% of their annual revenues; and (4) also places a ceiling on the price of an individual renewable energy credit.

COMMENTS ON THE ORIGINAL "STRAWMAN" VS. THE CURRENT DRAFT RULE

The original "strawman" proposal distributed by Staff as a starting point contained several principal features. The first was the use of the concept of the "renewable energy credit" or REC as a means of differentiating between the value of the capacity and energy associated with a renewable resource, on the one hand, and the value of the separate, distinguishable renewable attributes (few or no greenhouse gas emissions, renewable and non-depleting nature), on the

¹ From time to time during the workshops, an advocate of renewable technologies has pointed to the nuclear cost recovery factors as reasons to *increase*, not decrease, the amount of money to be spent on renewable energy credits. The argument goes, "If the Commission can spend \$400 million of customers' money on nuclear units not yet built, then it follows that more can be spent on renewable energy credits than the Staff's proposed rule contemplates." OPC finds this argument to be most illogical when seen from the perspective of the people paying the utility bills—the only perspective that counts when gauging this particular claim. Can one picture a family seated at the kitchen table planning the family budget, and concluding, "Now that we have depleted our bank account to replace the old car, we are better able to add the needed fourth bedroom to the house"?

other. For capacity and energy from renewable sources, the utilities would continue to be limited by their “avoided costs” (i.e. the costs they would incur to generate the electricity themselves, but for the availability of the renewable source). For renewable energy credits, or RECs, the utility would pay an amount determined by a to-be-developed market for such credits; however annually the amount would not exceed a ceiling that would be measured in terms of a percentage of the individual utility’s annual revenues. The strawman proposed a separate ceiling on the price of an individual REC that was tied to the value of avoiding the emission of a ton of greenhouse gas. The strawman contemplated that the various renewable technologies would compete on an equal footing; however, it contained “options” for discussion that would favor solar and wind technologies either by reserving a specified portion of the portfolio for them or by bestowing on them a “multiplier effect” that would enable a utility to meet its portfolio requirement more quickly with the favored technologies than with others.

The strawman was replaced by a draft rule that the Commission voted to propose on October 14, 2008. In the draft rule, the Commissioners proposed to increase the amount the utilities may expend for RECs from 1% of annual revenues to 2% of annual revenues. The draft rule deleted the separate ceiling on the price of an individual REC. The draft rule requires a utility to allocate 75% of monies available for RECs to the purchase of renewable energy acquired from solar and/or wind sources, and the remaining 25% to biomass and other technologies. The draft rule adds an explicit requirement that utilities issue Requests For Proposals for renewable energy at least every two years.

With respect to the goal of securing the most renewable energy at the most affordable price, OPC regards the provision requiring Requests For Proposals that was added to the draft rule as a good change. It should be incorporated in the final version of the rule. Competitive bidding is the best means of ensuring the most economical sources of renewable energy are tapped to meet the standard of the rule. The use of competitive means should not be left to chance or to the utilities' discretion.

OPC regards the deletion of the separate ceiling on the price of an individual REC as unfortunate. OPC urges the Commission to restore this feature in its final rule. Where the producers of renewable energy know the amount of money the utilities have to spend annually, and especially where the market for RECs is too immature to ensure effective competition, there could well be an ability of a bidder to an RFP to structure its proposal to commit the fewest megawatt hours in exchange for the highest price, thereby exhausting the "budget" for RECs at an early point. In that event, the utilities would turn to the Commission and say, "Too bad the money didn't stretch farther and purchase more credits, but we have spent the percentage of annual revenues the rule authorizes for the purpose, and by definition further purchases would be prohibitively expensive." The ceiling on the price of an individual REC would provide a "sanity check" that would prevent this scenario from occurring. Some participants objected to the specific maximum REC value that Staff included in the Strawman on the basis that it didn't capture the worth of all of the attributes of a REC. To the extent this argument may have some validity, the response should not be to scrap the concept, but to modify the ceiling appropriately.

OPC opposes the 75/25 allocation feature of the proposed rule. If adopted, this provision will impede the utilities' ability to meet their portfolio standards with the most economical and cost-effective sources. The differential between the cost of conventional generation sources and the cost of wind and solar technologies is greater, and the dollars needed to bridge the gap is higher, than the corresponding differences between the costs of conventional sources and other technologies. Said differently, each megawatt hour of energy from solar or wind technologies would cost more in total (energy cost plus cost of REC) to acquire than a megawatt hour of the non-solar and non-wind technologies identified as Class II sources within the draft rule. It follows that as the amount of money available to purchase RECs that is dedicated to solar and wind sources becomes larger, the total quantity of renewable energy that can be purchased with a given dollar amount (such as a specified percentage of annual revenues) becomes smaller. In its study of the potential for renewable energy in Florida, Navigant quantified the amount of renewable energy that could be expected if the 75/25 feature is incorporated in the rule. Despite the contentious nature of that provision, Navigant unfortunately did not quantify the total energy that compliance with the rule would produce if the rule did not require utilities to reserve 75% of monies available for RECs for the most expensive sources. OPC will address this shortcoming of the Navigant study in a separate section (below).

In lieu of the 75/25 provision, the Commission should incorporate within its rule the requirement that utilities issue frequent Requests For Proposals and allow the bidders to compete to provide the most economical sources of renewable energy. In the event different policy considerations lead the Commission to favor certain technologies within the rule, OPC urges the Commission to moderate the severe 75/25 split that is in the current proposed rule.

COMMENTS ON THE REPORT BY NAVIGANT CONSULTING

Navigant's draft report is impressive in many respects. However, in one important particular, Navigant's current work product should receive a grade of "Incomplete".

Perhaps the single most contentious item in the Commission's draft rule is the provision that requires utilities to dedicate 75% of monies available for Renewable Energy Credits to solar and wind-derived renewables (called "Class I technologies" in the Proposed Rule). Only 25% of the monies is to be used to acquire RECs associated with "Class II" technologies, which basically mean "all others." OPC and some of the other participants contend that all technologies should compete on an equal footing. Naturally enough, advocates of "Class I" technologies favor the allocation within the draft rule. In its draft report, Navigant quantified the total amount of renewable energy that it would expect to be generated over time pursuant to a rule containing the 75/25 allocation. However, Navigant did not quantify the corresponding amount of renewable energy that it would expect (given the same underlying assumptions) to be generated pursuant to a rule that makes no distinction between technologies with respect to the amount of REC monies available.

During the workshop, Navigant representatives said that Navigant studied only the 75/25 scenario because it was focused on tracking and quantifying the impact of the formulation within the proposed rule. However, with respect to other provisions, when it performed its analysis Navigant did not regard itself as tethered to the parameters of the proposed rule. The proposed

rule provides that 2% of the utilities' annual revenues will be the cap on expenditures for RECs. Navigant studied that scenario, but also quantified what the outcome would be if the ceiling were not 2%, but 1% and also 5%. The proposed rule contains a provision requiring the utilities to establish a market and mechanism for RECs; however, Navigant also examined a scenario in which there would be no RECs. In these areas, Navigant saw and acted on the need to study the "sensitivity" of the outcome to changes in particular variables (the inclusion of a REC mechanism and the percentage of utility revenues to commit to it). The need to quantify the differences between the proposed 75/25 allocation and the scenario in which all technologies would vie for a single pot of dollars is fully as compelling as the variables that Navigant studied.

While the Navigant representatives were reluctant to comment on the differences that would appear in the quantification of renewable energy that would be associated with a rule in which there is no 75/25 allocation without first having modeled the different scenario, OPC believes that some of Navigant's graphical depictions provide an indication of the direction in which the quantification of total renewable energy would move. At page 210, Navigant included a graph showing that, under the assumption that Class I technologies would receive 75% of the available dollars, the utilities would acquire energy from solar and wind resources (REC only) at prices ranging from \$150 to \$180 per megawatt hour, while the corresponding graph on page 211 indicates that, with 25% of the monies remaining for Class II technologies, the utilities would pay in the range from \$8 to \$18 per REC for those other sources. To think through the likely impact of deleting the 75/25 division, first assume that the money available to a particular utility is \$200 million. Under the provisions of the proposed rule, 75%, or \$150 million, would be dedicated to Class I technologies, and once there, would be used to purchase RECs at a cost of

approximately \$150 per REC. The remainder, or \$50 million, would be available to less expensive “Class II” technologies.

Now assume there is, instead of the 75/25 allocation, a single pot of dollars that a contender may access only if it is determined (based on the results of a competitive selection process) to be among the most cost-effective proposals. Rather than only \$50 million being dedicated to the most economical sources, the single “pot” of money for which all vendors vie is now \$200 million. While the “iterative process” described by Navigant on pages 210-211 is needed to calculate and quantify the results of this scenario, OPC believes the thrust and direction of the analysis are clear: more renewable energy would be realized in total without the separate allocation to solar and wind than with it.² So that the Commission’s decision as to whether to adopt a proposal that would allocate 75% of REC monies to solar and wind resources is informed by the Navigant study, OPC calls on the Commission to direct Navigant to quantify the total megawatt hours of renewable energy it would expect to be generated if the final rule were to replace the 75/25 allocation of the proposed rule with an approach that establishes a single “budget” to be awarded to the most cost-effective projects.

COMMENTS ON COMMISSIONER SKOP’S PROPOSAL

² One of the slides in Tom Ballinger’s presentation indicates to OPC that Staff agrees the effect of devoting 75% of monies available for purchasing RECs to solar and wind projects would be to generate fewer megawatt hours of renewable energy than would be the case if no segregation of resources were made. (See Slide No. 21: In each scenario, the revenue cap necessary to achieve a given goal is highest with “all solar,” lowest with “all biomass,” and the 75/25 case falls between the most expensive and the least cost scenarios.)

During the workshop on December 3, Commission Skop distributed a conceptual outline of an alternative approach to the rule, which became the subject of discussion. Commissioner Skop's alternative concept includes the following elements:

- (1) 5% of the monies collected from customers for the purpose of complying with the rule would be allocated to the program for providing rebates to customers who elect to install solar facilities that is currently administered by the Florida Energy Office.
- (2) The rule would require the electric utilities to maintain "standard offer contracts" that may be accepted by providers of renewable energy. The concept envisions that there would be four such contracts corresponding to the four principal categories of renewable technologies. Each would be "appropriately priced," by which term we understand Commissioner Skop to mean that the revenue stream of the contract for each respective technology would be designed to be sufficient to attract proposals, and to enable a project to obtain financing.
- (3) RECs associated with the renewable energy generated under the standard offer contracts would inure to the purchasing utilities, who could then sell the RECs to out-of-state entities in a multistate market. Proceeds would be applied to offset the costs of complying with the portfolio standard being borne by customers.

While everyone agreed that the "devil is in the details," OPC has the following preliminary comments on the proposal.

First, while as a general matter OPC opposes carveouts and set asides, OPC regards the proposal to allocate 5% of the monies otherwise earmarked for RECs to the solar rebate program as a reasonable compromise between those who advocate provisions that favor particular technologies and those who favor “head to head” competition among vying producers. OPC recognizes that the provision is responsive to those who describe the need to construct a rule that will not “shut out” smaller installers of solar facilities.

Next, while OPC has not studied, at the time these comments are being prepared, whether (as some participants suggested) the provision enabling utilities to market the RECs to out-of-state entities raises legal issues, conceptually OPC favors this and any other practicable and legally permissible avenues for offsetting the costs that hard-pressed customers will be required to bear under the rule.

As Commissioner Skop noted, the rule that the Commission ultimately adopts will operate in an environment that is “resource constrained.” The most conspicuous example of constrained resources will be the ceiling on the amount of money a utility may expend on RECs annually. It follows that establishing four categories of standard offer contracts would necessitate allocating available funds among the four categories. Otherwise, given that the concept is to design a “standard offer” for each technology that is financially sufficient and commercially attractive, one can be certain that the contracts would attract more proposals than the available monies could fund. The biggest policy challenge would be to develop criteria for deciding how much of the available money to allocate to each standard offer. Because OPC regards the 75/25 allocation of the current proposed rule as severe, it is possible that, depending on the outcome of

the exercise of allocating dollars among four categories of renewables, OPC may prefer this approach to the proposed rule. However, especially in view of the separate provision that would dedicate a portion of the monies to the solar rebate program, OPC would prefer to see the four separate “buckets” of dollars converted into a single category.

Whether there are four categories or one, if the standard offer format goes forward OPC submits it would be important to include within the contracting provision an explicit mechanism for injecting competition into the process. While broad industry cost data is available, OPC believes the Commission is not in a position to know, for example, whether a particular vendor may have an advantageous cost structure that, in a competitive arena, would cause it to offer a price more economical than a generic “standard offer,” or whether another may be willing to accept a lower internal rate of return in order to establish an initial presence in the state. Nor can the Commission gauge the role that such considerations as tax policies, grants, and venture capital will play in the development of renewable projects. Moreover, OPC believes that the motivating influence of competition will help drive costs of renewable energy toward “grid parity.” If the format of a standard offer contract is adopted within the rule, the price of the contract should be a maximum price, and the utility should be directed by the rule to conduct competitive processes designed to solicit more economical proposals. During the workshop, Commissioner Skop said he was amenable to the inclusion of an auction or similar competitive process that would work in tandem with the four categories of “standard offer contracts” shown on his conceptual diagram.

COMMENTS ON TOM BALLINGER’S PRESENTATION

During his presentation, Mr. Ballinger referred to slides that depicted the relative costs of solar and biomass sources of renewable energy. Based upon the price of the renewable energy credit that would be necessary to acquire a megawatt hour of each, Mr. Ballinger's slides indicated that a renewable portfolio of "pure solar" would cost substantially more than a corresponding renewable portfolio of "pure biomass." (See Slide Nos. 18 and 19)

Relating the cost of one technology to another on a "stand-alone" basis provides useful information. Focusing solely on the price of RECs may exclude other cost impacts that arise from a consideration of the utility's entire system.

During the workshop, references were made to the differing capacity factors of renewable technologies. For example, the capacity factor of solar technology falls in the range of approximately 8% to 14%, because solar is most effective only during the hours of direct sunlight. Biomass has a far greater capacity factor, and can operate during peak hours.

During the first several years, the percentage of a utility's portfolio consisting of renewable energy will be relatively small, and the contributions of any single technology to meeting peak requirements will be minor. However, under the rule the portion of a portfolio consisting of renewable sources will ramp up over time to meet the ultimate standard. A renewable producer that is generating at the time of system peak is doing "double duty;" that is to say, the producer is enabling the utility to meet its renewable portfolio standard at the same time it is also contributing to the ability of the utility to meet system peak demand. On the other hand, a

renewable source having characteristics that prevent it from operating at the time of system peak would provide only the portfolio standard benefit. In that instance, the utility may be required to invest in the renewable resource and also acquire separate capacity with which to meet its peak demands. For these reasons, it appears to OPC that a calculation based solely on the relative costs of renewable energy credits may understate the full cost to customers of a renewable energy source that has a low capacity factor.

COMMENTS ON MARK FUTRELL'S PRESENTATION

Much of Mr. Futrell's presentation focused on the manner in which a utility would recover the costs of complying with the requirements of a Renewable Energy Portfolio standard. For purposes of these comments, OPC wishes to distinguish between the costs associated with RECs and purchased power costs, on the one hand, and the costs of utility-owned renewable sources, on the other. It appears to OPC that the complexities of administering a market for the RECs acquired from other sources may warrant the use of an existing or a separate cost recovery mechanism. However, OPC firmly opposes the creation of a new cost recovery clause for utility-owned renewable sources. OPC believes any concern over a perceived or claimed "disincentive" that such a mechanism would be intended to overcome is misplaced. More importantly, to allow a utility to flow the costs of its renewable resource through a clause when base rates are more than adequate to absorb those costs would result in customers' total bills being higher than necessary to support a renewable energy portfolio.

A concern over a perceived or claimed “disincentive” would be misplaced. Mr. Futrell included a possible cost recovery clause for utility-owned renewable resources to address the notion that a utility may have a disincentive to invest in a renewable resource due to “regulatory lag, rate case complexity, and expense.” (See Slide 15.) To consider the premise of a disincentive, it is important to have in mind the purpose of base rates and the nature of base rate proceedings generally. Base rates are designed to cover a myriad of costs—depreciation expense through which a utility recovers its capital investment in plant, operating and maintenance expenses, taxes, labor costs, insurance costs, to mention a few. Revenues generated by base rates are a function of the number of customers, growth in customers over time, and changes in consumption. Base rates are designed to yield a return that falls within a range—frequently 200 basis points-- considered by the Commission to be fair.

The utility’s mix of costs and revenues is dynamic over time. Once base rates take effect, there certainly will be numerous changes in the makeup of the utility’s costs of providing service. Some costs may increase; others may decrease. Some costs—such as those that the utility has been directed to amortize on a given schedule—will vanish completely. The utility will retire some items of plant, thereby ending related depreciation expense and return requirements, and will invest in new items of plant, which will be added to rate base. On the revenue side, customer growth and/or increases in consumption may increase revenues in a manner that would completely offset any unanticipated new costs. Because base rates are aimed at a range rather than a point target, base rates frequently can function over a sustained period of time, absorbing new plant items and yielding a fair rate of return.

A utility is obligated to provide efficient and reliable service to its customers. Again, the nature of its business is that, in the course of providing reliable and efficient service, some costs will increase and others decrease over time. A utility cannot expect to receive an increase in base rates each time it must incur new base rate-related costs to meet its obligations. To refuse to incur the costs necessary to provide the required standard of service would be to accept the benefits and advantages of being a regulated monopoly but to shirk the responsibilities and obligations that its special status involves.

In many instances, revenues generated by base rates may be sufficient to absorb even substantial new investments in plant and continue to yield a fair return (see paragraph below). In the event that an investment in a renewable would have the effect of lowering a utility's earned rate of return to a level that it believes is unfair, it has the ability to ask the Commission to increase its rates, and where warranted the Commission has at its disposal tools (such as an interim increase) that would overcome regulatory lag. There is nothing unfair or out of the ordinary for such an occurrence. It is how regulation is designed to work.

To allow the utility to collect the costs of a utility-owned renewable resource through a separate cost recovery clause when base rates are sufficient to absorb the costs and yield a fair rate of return would cause customers to pay total bills higher than necessary to support the investment. When considering the ramifications of yet another separate cost recovery clause, OPC submits the focus should be more on the negative repercussions for customers and less on unwarranted “disincentives,” for in establishing such a clause the Commission would be creating the very real possibility of enabling the utilities to overcharge customers. With the “overall”

nature of proceedings to set base rates in mind, consider a situation in which a utility's base revenues are sufficient to absorb (without an increase in rates of any kind) the cost of an investment in a renewable resource and continue to yield a return on overall investment, including the renewable resource, that falls within the range of reasonableness established by the Commission. (This is no abstract or hypothetical idea; for example, over an extended period, Florida Power & Light Company absorbed several new power plants --that is, placed them in rate base when they began commercial operation and recognized their costs in the company's calculations of earned rate of return-- without seeking an increase in base rates.) ***In that circumstance, the utility will by definition be receiving a fair return on its investment in the renewable resource, and customers' bills will not have changed.*** (Further, as Mr. Futrell's slides indicate, because a renewable resource requires a capital investment larger than a corresponding investment in a conventional technology, the utility will earn correspondingly more from its investment in the renewable—a sufficient incentive in itself.) If base rates are sufficient for this purpose and the utility nonetheless is allowed to pass the costs of the renewable resource through a separate cost recovery clause, customers' bills will ***increase unnecessarily*** by the amount of the costs of the renewable resource. Of course the utilities have an *incentive* to steer as many costs through as many separate cost recovery mechanisms as they can persuade the Commission to create; however, the Commission should reject the premise of a “disincentive,” recognize the very real potential for harm to customers in creating more and more cost recovery clauses, and require utilities to look to base rates as the vehicle for recovering the costs of investments in company-owned renewable resources.

CONCLUSION

OPC respectfully requests the Commission to consider these Comments as it proceeds to develop the Renewable Energy Portfolio Standard.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing **OPC'S COMMENTS ON
DECEMBER WORKSHOP** has been furnished by U.S. Mail and electronic mail to the following parties on this 8th day of December, 2008.

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