

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Investigation of Pennsylvania's Retail : Docket No. I-2011-2237952
Electricity Market: End State of Default :
Service :

**COMMENTS OF
CONEDISON COMPETITIVE ENERGY BUSINESSES**

The ConEdison Competitive Energy Businesses (“CEBs”) submit these comments in response to the Commission’s November 8, 2012 Tentative Order issued in the above-referenced docket. The ConEdison Competitive Energy Businesses include Consolidated Edison Solutions, Inc. (“CES”), a licensed Electric Generation Supplier (“EGS”) serving residential and commercial retail customers in the Commonwealth, Consolidated Edison Development, Inc. (“CED”), a developer, owner and operator of renewable energy assets throughout the United States, and Consolidated Edison Energy, Inc. (“CEE”), a wholesale power marketer and provider of asset management services to more than 7,500 MWs of generation in PJM, NYISO, and ISO-NE. Collectively, these companies make up the ConEdison Competitive Energy Businesses, a diversified group of energy service companies participating in competitive wholesale and retail energy markets in Pennsylvania and other restructured states.

I. Introduction

The CEBs respectfully submit the following comments in response to the Tentative Order’s request for comments on the proper role and structure of continued Electric Distribution Company (“EDC”) long-term contracting for Alternative Energy Credits (“AECs”). As explained in more detail below, the CEBs support properly structured policies, including EDC long-term contracting for AECs, which are designed to promote continued investment in renewable energy projects. However, any such policies should be carefully structured so as to promote competitive neutrality between EDC default service pricing and EGS prices and to avoid disrupting existing contracts that EGSs have in place with their retail customers and AEC

suppliers. Because the various Pennsylvania EDCs currently have in place different policies and cost recovery structures for their AEC procurements, it may be appropriate to continue an EDC-specific approach for any future AEC long term procurements.

Although these comments are focused on the AEC long-term contracting issue, the CEBs are also keenly interested in the Commission's End-State policy recommendations regarding default service procurement and pricing. ConEdison Solutions is an active member of the Retail Energy Supply Association ("RESA"), and hereby endorses the comments that RESA is submitting with respect to the End-State default service recommendations. The CEBs fully support the recommendations in the Tentative Order to promote more market responsive default service pricing through the expansion of hourly priced default service to smaller medium commercial customers (e.g., the 100 kW threshold as recommended in the Tentative Order) and the use of quarterly, full requirements procurements for residential and small business customers. While the CEBs believe that the default service pricing reforms outlined in the Tentative Order are a beneficial step towards a more sustainable retail market design, we share the concerns articulated by RESA that more significant structural reforms are needed to truly foster a sustainable retail market design.

II. The CEBs Support Properly Structured and Competitively Neutral Policies to Promote Renewable Energy Development

The CEBs, representing the collective interests of three distinct market segments of the energy industry, can offer a unique and well balanced perspective on the issue of utility long term contracting for AECs. As a general matter, the CEBs support well crafted policies intended to promote the development of renewable energy resources in the Commonwealth. Pennsylvania is a leading example of a state with well-balanced energy policies that both promote renewable energy interests while simultaneously promoting competitive market development, including robust retail competition. The CEBs encourage the Commission to maintain this balance going forward.

Long-term contracting by utilities for AECs, if properly implemented, can be an effective policy tool to promote the continued development of renewable energy resources. However, it is critical that such long-term contracting is implemented in a thoughtful manner that does not

impede or undermine the development of retail competition in the Commonwealth. Accordingly, the cost recovery structure utilized by an EDC to recover the costs of its long term AEC purchases is a critical consideration. There are three general approaches that can be taken with respect to AEC procurements:

- (i) **The EDC procures AECs for all load (including default service load and shopping load) and recovers the cost through a non-bypassable charge.**

This is the approach that Met-Ed and Penelec have taken in their current default service plan for solar AEC purchases. The EDCs procured Solar AECs through long-term competitive solicitations and obtained a sufficient amount of supply to meet the Solar Alternative Energy Portfolio Standard (“AEPS”) requirements for all load in their service territories, including load served by EGSs. One benefit of this approach is that the EDC is better positioned to engage in long-term contracting because it has a statutory right to recover costs. The EDC long-term procurement of solar AECs can help stimulate demand and create a stable future revenue stream for solar projects, thus creating better opportunities to finance projects in the development stage. Because the costs of the long-term AEC contracts do not influence the resultant Price to Compare, the cost recovery structure is competitively neutral for EGSs. This eliminates the risk that the AEC component of the EDC’s default service price will become divorced from current market prices as a result of the long-term contract. However, a potential downside of such a procurement structure is that it removes an opportunity for EGSs to extract a competitive advantage through more efficient solar AEC procurement. Because the EDC assumes the procurement responsibility for solar AECs, this model does not allow EGSs to compete with one another, and with the EDC’s default service, in terms of this pricing component.

- (ii) **The EDC outsources its AEC requirements to wholesale, full requirements energy suppliers who reflect the cost of AECs in their bid prices which are reflected in the EDCs’ fully bypassable Price to Compare.**

From a retail cost recovery perspective, this procurement approach which fully outsources the AEPS compliance obligation to winning wholesale default service suppliers, is also competitively neutral. Under this approach, the cost of AEPS compliance is fully reflected in the by-passable Price to Compare (“PTC”) because wholesale suppliers imbed their projections of

such costs in their default service bids. Because competitive wholesale suppliers must account for this cost in their default service bid prices, there is a clear incentive to price such AEC requirements consistent with current competitive market conditions. With this type of procurement structure, the EGS is also responsible for all of its AEPS obligations. One benefit of this approach is that AEPS compliance remains a competitively priced component of both default service and EGS pricing. This preserves the ability of EGSs to extract a competitive advantage by building a better AEC-procurement mousetrap. However, the downside of this model is that there is arguably little incentive for long-term contracting for AECs. Because the wholesale default service suppliers only serve load for the duration of the underlying default service contract (which, pursuant to the recommendation contained in the Tentative Order would be limited to three months), it would not be prudent for such suppliers to procure AECs for a longer term. EGSs also have a transient customer base and similarly are not predisposed to enter into long-term AEC contracts. So, while this model is competitively neutral and perhaps even preferable to 100% EDC-procurement of AECs, it may not meet the Commission's policy objective of promoting renewable development by encouraging long-term contracting of AECs.

- (iii) The EDC procures a specified amount of AECs through a separate procurement and uses these AECs to fulfill some of its AEPS requirements; wholesale default service suppliers meet the residual AEC needs.**

Some EDCs have utilized this hybrid approach for AEC procurements. For example, both PPL and PECO have conducted procurements of AECs under their default service plans. Although these EDCs rely predominantly on full requirements, wholesale supply for default service, the EDCs still conducted RFPs for specified amounts of solar and non-solar AECs. The EDCs' costs of such procurements are reflected in the bypassable Price to Compare. The residual amount of AECs needed to ensure AEPS compliance for default service load is supplied by winning wholesale full requirements suppliers who reflect these costs in their bid prices. Under this approach, the Price to Compare reflects the combination of the EDC's cost of AEPS procurements plus the residual amount of AECs that wholesale suppliers are responsible for, which is imbedded in default service bid prices. Although the resultant PTC does reflect the cost of AEPS obligations, this approach can create adverse results if the EDC's price of long-term AEC purchases becomes divorced from current market prices for AECs. For example, if

under such a hybrid procurement model, the EDC procures a large amount of AECs via long-term contracts, and the price of AECs rises significantly in the future, the EDC's PTC may enjoy an undue pricing advantage relative to EGS offers because it would reflect an out of date price for AECs.

III. Treatment and Cost Recovery for Existing Long-Term AEPS Contracts

In the Tentative Order, the Commission recognized that each of the above approaches have been utilized in the existing default service plans. The Tentative Order provided for the following in terms of cost recovery for exiting EDC long term AEC contracts:

Therefore, on a case-by-case basis, EDCs may propose the means by which these contracts will be addressed on the issue of cost recovery. Such means may include, but are not limited to, the inclusion of incurred costs in the PTC, the inclusion of incurred costs in a non-bypassable surcharge, or the voluntary assignment to an EGS or EGSs. (Tentative Order at 35.)

The CEBs agree that cost recovery for long-term AEC contracts and the disposition of the AECs associated with such contracts is best determined on an EDC by EDC basis given the different procurement and cost recovery approaches that the EDCs currently employ. However, the CEBs request that the Commission explicitly require a competitively neutral cost recovery structure. Each of the three cost recovery methods outlined in the Tentative Order is directly connected to a particular AEC procurement approach as outlined previously. For example, the Tentative Order would permit the inclusion of incurred costs in the PTC in some cases. However, in order to maintain competitive neutrality, this approach is only warranted where the EGS remains responsible for all or a portion of the AEPS obligation. It would not be appropriate, for example, if Met-Ed and Penelec were to recover the costs of their solar AEC procurements through the PTC while still assuming the entire solar AEPS obligation for both EGSs and default service load. This would provide EGSs, who avoid the solar obligation, with an undue competitive advantage as compared to default service.

The Tentative Order would also permit inclusion of incurred AEC costs in a non-bypassable surcharge in some cases. In service territories such as PPL and PECO, where EGSs are responsible for 100% of the AEPS obligation, it would not be appropriate to permit the EDC to

recover the costs of any separate AEC procurements via a non-bypassable charge if the long-term contracted AECs are utilized to meet the AEPS requirements for the EDC's default service customers. If the cost of such AECs are recovered via a non-bypassable charge and the procured AECs are retired for default service AEPS compliance, this would result in a competitive disadvantage for EGSs, because EGS customers are forced to pay, via the non-bypassable charge, for AECs that they receive no benefit from.

Accordingly, while each of the cost recovery methods provided for in the Tentative Order may be appropriate in specific circumstances, the cost recovery method is directly linked to the overall AEPS procurement approach. The CEBs respectfully request that the Commission clarify that in allowing for an EDC-by-EDC approach to cost recovery for AECs, the Commission will require in all instances a competitively neutral outcome.

IV. Future Long-Term Alternative Energy Credits Contracts

In the Tentative Order, the Commission requested comment on several issues related to the future EDC procurement of AECs through long-term contracts. The Commission also articulated the following policy encouraging continued long-term contracting for AECs:

The Commission believes that an AEC procurement methodology whereby either the EDC or the DSP satisfies a portion of their service territory's AEPS requirements will help facilitate a successful capacity build-out of AEPS-qualified generation facilities by mitigating long-term cash flow risks for relevant generation owners or financiers.
(Tentative Order at 37)

In articulating this position, it appears at the Commission wishes to continue its policy of promoting the long-term financeability of renewable resources by encouraging EDCs to conduct long-term contracting for AECs. As a general matter, the CEBs support such a policy. As stated earlier, if properly implemented in a competitively neutral manner, EDC long-term contracting for AECs can be an effective policy tool for encouraging continued renewable energy investment without negatively impacting the retail market. Before commenting on the specific questions raised in the Tentative Order on this subject, the CEBs would like to offer the following recommendations regarding the continued structure for EDC long-term AEC procurements.

- (i) **EDCs that already procure 100% of an AEPS requirement for all load should continue to assume these requirements and may procure such AECs via long-term contracts.**

As mentioned earlier, Met-Ed and Penelec currently assume the solar obligation for all load in their service territories and conduct long-term RFPs to acquire the Solar AECs needed to meet the solar AEPS requirements. For these EDCs, the CEBs recommend continuing the existing practice of procuring 100% of the solar AEC requirements for all load with recovery of such costs through a non-bypassable surcharge. EGSs operating in these service territories have already developed pricing models and have entered into contractual arrangements with customers reflecting the fact that EGSs are not responsible for the solar compliance obligation. Continuing the current solar AEC procurement arrangement for these EDCs will prevent disruption to existing EGS procurement arrangements and contractual relationships with customers. Doing so will also stimulate demand for continued solar development by creating a long-term revenue stream for project developers that sell their AECs to the EDCs. In the event that the default service role is assumed by an entity other than the EDC, it would also be possible for the EDC to continue its role in procuring solar AECs and meeting the solar AEPS obligation for all load. The EDC may be better positioned to conduct such long-term procurements given its ability to recover such costs from ratepayers.

- (ii) **For EDCs that outsource the AEPS obligation to wholesale suppliers, future EDC long-term contracting should be disconnected from the default service obligation.**

For those EDCs outsourcing the entire AEPS obligation or that have historically conducted only limited AEC procurements and utilized such AECs only for default service AEPS obligations, it is also appropriate to continue the status quo in terms of AEPS responsibility. This need not prevent a role for EDC long-term contracting for AECs. For these EDCs, where EGSs and wholesale suppliers are accustomed to meeting their individual respective AEPS obligations, the EDC can still conduct long-term contracting for AECs. However, such long-term AEC procurements should be disconnected from the default service procurement structure such that the acquired AECs are not utilized for AEPS compliance obligations. Under this approach, the EDCs would conduct RFPs to purchase, on a long-term basis, a specified quantity of AECs and/or Solar AECs. Instead of holding the acquired AECs

and utilizing them for either default service AEPS obligations or for all retail supplier AEPS obligations, the EDC would sell the AECs back into the market through an annual auction according to a pre-set schedule set by the Commission. The EDC would recover its net cost of these AEC purchases via a non-bypassable charge or credit from all customers. If the EDCs sold the AECs back into the market at a price higher than the long term contract price, customers would receive a net credit. Conversely, if the AECs are sold at a price lower than the long term contract price, customers would experience a charge. This approach would continue to maintain competitive neutrality for default service pricing because the EDC procurement of RECs would not influence the PTC. Because EGSs and suppliers would remain responsible for 100% of the AEPS obligation, this approach would also allow EGSs and wholesale suppliers to maintain their current AEPS hedging strategies. EGSs who may already have procured a significant amount of their future AEPS requirements would not be impacted. Additionally, those EGSs that believe they can extract a competitive advantage by procuring AECs at a lesser cost than competitors, can still maintain this opportunity for differentiation. This approach has been utilized by EDCs in NJ and is generally viewed as a successful and competitively neutral approach to EDC long-term contracting for renewable resources.

This approach is also beneficial because it can be implemented regardless of who has the default service role and regardless of how many customers remain on default service. One of the concerns raised during the Retail Market Investigation discussions was that it may be imprudent for an EDC to continue significant long term contracting for AECs when they have a diminishing set of default service customers for which to meet an AEPS obligation. Under the above recommended approach, this is not a concern because the AEC long-term contracting is not connected to the default service obligation or the AEPS requirements of a particular group of customers. The EDC long-term contracting merely serves as a policy tool to promote renewable energy development by fostering long-term demand for AECs.

V. Response to Specific Questions in Tentative Order

The Commission sought comments on several specific questions on the issue of long-term contracting for AECs. The CEBs' responses to these questions are as follows.

- (i) **Whether an EDC or an alternative DSP approved by the Commission consistent with 66 Pa. C.S. Section 2807(e)(3.1) and applicable regulations should file a procurement plan for Tier I, Tier II, and Solar AECs with the Commission;**

CEB Comments:

The CEBs take no position on whether an EDC or an alternative DSP should be required to submit a procurement plan for Tier I, Tier II and Solar AECs with the Commission. However, as stated previously, the CEBs do support policies that promote continued EDC procurement of AECs through long-term contracts provided that cost recovery for such procurements is structured in a competitive neutral manner.

- (ii) **Whether it would be more appropriate to have this function fulfilled by an EDC (regardless of whether it has a default service obligation) or the entity providing default service**

CEB Comments:

If encouraging renewable energy development through the use of long-term contracting is the desired policy goal, then there are certain advantages to utilizing the EDC as the conduit for such long-term contracting. As stated previously, it is more practical for EDCs to enter into long-term AEC contracts because they have a right to recover such costs from ratepayers. Requiring an alternative default service provider, which would presumably be an EGS or a wholesale supplier providing full requirements service to the EDC, to enter into long-term AEC contracts would be problematic because such entities may not have a consistent customer base and may not have the same ability to recover long-term contract costs from customers.

- (iii) **Whether these procurements should include a mix of short-term (one year or less), medium-term (one to five years), and long-term (six to ten years) contracts, or whether procurements should be EDC territory fact-specific, tailored specifically to each EDC territory's unique circumstances, requirements and market conditions**

CEB Comments:

As stated in the previous section, the CEBs believe that EDCs, such as Met-Ed and Penelec, who currently meet the solar obligation for all load through long-term solar AEC

purchases, should continue to do so. For other EDCs and for the Met-Ed and Penelec non-solar obligation, where the EGS is responsible for the AEPS obligation, the CEBs recommend the following approach: (i) the EDC procures a specified quantity (established by the Commission) of AECs through long-term contracts and then sells the AECs produced and procured each year back into the market through an annual auction, (ii) the net costs of such procurements would be recovered through a non-bypassable charge or credit, and (iii) EGSs and wholesale default service suppliers would remain responsible for their respective AEPS obligations. The CEBs take no position on the appropriate term for such EDC AEC contracts. However, it should be noted that this structure provides greater flexibility to the Commission because the term of the AEC contracts need not be connected to the underlying term of the default service contracts.

- (iv) **If procurement is to be a mix of contract durations, we request comment on whether the procurement schedules should aim to procure AECs necessary to comply with up to 50 percent of the zonal load for any given service territory and allocate those AECs on a pro-rata share among the EGSs operating in its zone, entirely among the default service load, or some mix of both**

CEB Comments:

EDCs such as Met-Ed and Penelec who currently meet 100% of the solar obligation for all load should continue to do so. In EDC service territories where EGSs are currently responsible for the entire AEPS obligation, the CEBs take no position as to the appropriate amount of AECs that should be procured through EDC long-term contracts. The CEBs note, however, that our recommendation to separate the EDC procurement of AECs from the default service and AEPS obligations would provide the Commission with greater flexibility to adjust the quantity of future EDC long-term AEC procurements. This is because the amount of AECs would be independent from the amount of default service load served by the EDC. This recommendation would also eliminate the need to develop a mechanism for allocating EDC-procured AECs to various EGSs operating in the EDC's zone, because each EGS would remain responsible for 100% of its AEPS obligation.

VI. Conclusion

In conclusion, the CEBs applaud the Commission's continued efforts to promote the development of retail competition in the Commonwealth while also pursuing sound policies to promote renewable energy investment. The CEBs appreciate the opportunity to submit these comments.

Respectfully submitted,

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