

**House Republican Policy Committee
Consumer Costs of State-Mandated Energy Programs**

**Testimony of
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Thank you, Chairman Reed, and members of the Committee, for holding this important hearing today to discuss the panelists' experiences from implementing state-mandated energy programs, including the cost to consumers.

I am Romulo L. Diaz, Jr., and serve as Vice President for Governmental and External Affairs at PECO. PECO serves approximately 1.6 million electric distribution customers in southeastern Pennsylvania and nearly half a million natural gas customers in the four counties surrounding Philadelphia.

Electric customers in Pennsylvania pay for the costs of several state-mandated programs. Costs for implementation of state-mandated programs are the fastest-growing portion of our customers' total electricity rates. These costs are affecting the ability of our customers, especially our low-income customers, to pay their bills.

Let me be clear, environmental stewardship is one of PECO's core values. We have and will continue to work aggressively to ensure that our company meets all the requirements of the Alternative Energy Portfolio Standards (AEPS) and Act 129 of 2008 (Act 129).

As with anything else, however, there are more effective and less effective ways of achieving the goals of each program. In some cases, our state regulators have been provided the discretion to ensure that programs are implemented cost-effectively. However, in others, statutory language does not allow such flexibility and, as currently structured, creates higher than necessary costs for achieving the fundamental goals of the programs.

Given the economic pressures facing Pennsylvania's families, governments and businesses, we at PECO are working as aggressively as possible to manage our costs. We believe that we have an obligation to our customers to ensure that our overall business and the programs we administer are run in a cost-effective manner. Reviewing these state-mandated programs and seeking ways to make them more cost-effective is an important part of our efforts.

In my testimony today, I will provide some suggestions that would enhance several of the Commonwealth's environmental programs through cost containment and cost efficiency measures. Our experience has been that some of these programs have been successful and cost-effective, but others can be improved while maintaining their basic structure, and a few require fundamental re-thinking.

AEPS

PECO is ahead of schedule for compliance with AEPS requirements and was the first Electric Distribution Company (EDC) in the state to hold procurements for both Tier 1 non-solar and long-term solar alternative energy credits (AECs). For the most part, the

regulatory structure of the AEPS program is well-organized, but cost containment measures and regulatory certainty can be improved.

EDCs and Electric Generation Suppliers (EGSs) are required to purchase AECs for compliance with the PA AEPS. EDCs and EGSs are subject to an Alternative Compliance Payment (ACP) if they do not purchase the required number of AECs in a given energy year. The ACP is generally acknowledged as the “cap” that AECs would be sold for.

Under Pennsylvania law, the current ACP structure is flawed due to ACP prices that are arbitrary and not linked to historic or projected market prices. For example, the Tier 1 non-solar ACP of \$45 is far above both the market price for short-term and long-term AECs. Additionally, the ACP is significantly above independent projections of \$18 to \$25 costs for new wind development, the most expensive of the Tier 1 non-solar resources.

In order to function as an effective cost containment mechanism, the Tier 1 ACP should be set at the top end of the range of new building development costs – approximately \$25 per credit – and gradually reduced by \$1 each year to reflect continuing cost efficiencies in renewable energy development.

Solar ACPs provide even less protection to consumers because they are set at two times whatever the market price is, regardless of how high it may be. This raises the potential for an upward spiral of solar AEC prices as the mandates in Pennsylvania and our neighboring states escalate.

PECO strongly believes that the “200 percent of market” solar ACP rate should be replaced with a fixed ACP that declines gradually over time, similar to other Tier I resources. Based on market experience and costs of developing new solar projects, we recommend a \$250 solar ACP that declines by \$10 each year to reflect increasing production efficiency. This will allow the ACP to serve as a true cost containment mechanism for consumers without hampering the AEPS goal of spurring renewable resources development. This also establishes a limit on the premium Pennsylvania consumers will pay for solar energy compared to other emission-free resources, setting that limit at 10 times the cost of Tier 1 resources, while applying a fixed ACP to all tiers.

Adjusting ACP levels in this manner represents a no-lose proposition for consumers. If renewable developers are able to deliver on anticipated efficiency improvements and pass cost reductions along to consumers, EDCs will never need to make ACPs. If, however, it turns out that those expectations are not met, consumers will still see the price protection.

The value of consumer price protection varies depending on assumptions, but if the ACP adjustment ensures a 4 percent per year reduction in AEC prices below today’s estimated new build cost, consumers will save approximately \$30 million per year by 2021 in the PECO zone alone.¹

Additionally, sections of the AEPS law dealing with ACPs and force majeure should be clarified to eliminate ambiguities that currently exist and improve regulatory certainty. We’d be pleased to work with the Committee on these issues.

¹ Based on assumed AEC prices of \$21.50 for Tier I resources and \$250 for solar resources through 2021.

Act 129 Energy Efficiency Programs

In general, PECO believes that the energy efficiency programs mandated by Act 129 have functioned as intended and are providing consumers tools to save energy and money. While Act 129 sets mandates and stringent penalties of up to \$20 million, it does not provide EDCs any incentive for exceeding these requirements.

One recommendation we make to maximize savings and minimize costs is to modify the law to allow utilities to apply any reductions in excess of the energy efficiency targets toward any future Act 129 compliance period or a portion of Tier 1 AEPS requirements, or to propose incentive-based programs to the Commission. From the customer's perspective, they have already paid for the programs and any extra reductions should be utilized to their full potential in offsetting other costs. From the utility perspective, EDCs will be encouraged to execute programs in a manner that deliver consumer savings at the earliest possible date.

Act 129 Demand Response Programs

In 2008, the Legislature passed a unique mandatory demand response program with minimal legislative deliberation. This program requires EDCs to reduce peak system load by 4.5 percent across the "100 top hours" of load during the summer of 2012. The goal of the mandate was to reduce consumer prices during peak load periods.

Unfortunately, there were significant flaws in both the details and overall premise of this legislation. EDCs cannot predict in advance what the "100 top hours" of load will be any given summer and, therefore, must substantially overcomply – that is, enact programs that reduce customer load across a wider number of hours – in the hope of hitting the "right" 100 hours. Also, in many summers, when temperatures and prices are low or moderate, it makes no operational sense to pay consumers to use electricity at different times than they normally would, particularly over so many hours.

Historically, we have seen summers where the requirement would have forced us to pay customers to shift load away from hours when prices were below average, had the demand response requirement been in place.

For the 2012 demand response compliance period, PECO recommends replacing the "top 100 hours" with an objective peak load trigger that would be established based on PJM's summer peak load forecast. This would ensure that load shifting occurs during times of high prices and operational constraints, but not based on an arbitrary and operationally unnecessary requirement. In the PECO zone alone, this change would save our customers at least \$6 million during the 2012 summer compliance period.

In the longer term, we believe the demand response mandate should not be continued, and that the market-based, operationally-driven programs administered by PJM should perform this function instead.

Net Metering

Finally, PECO believes that the Legislature should eliminate the inequitable consumer cost-shifting created by Pennsylvania's net metering laws. Net metering allows customer-generators to reduce their electricity bills by offsetting the value of excess generation they produce. The manner in which it is accomplished, however, provides a windfall to customer-generators, at the expense of other customers.

PECO agrees that customer-generators should be able to offset generation costs, but under current law, they receive a credit of the full retail rate, which inappropriately provides a distribution and transmission credit as well. Additionally, those costs are paid for by other EDC customers. PECO strongly opposes forcing the vast majority of our customers to subsidize the transmission and distribution costs of net metering customers. This cost shifting will grow with each passing year that we don't address the issue. Our internal estimates show costs growing to more than \$8 million per year by 2021. We have provided the Committee with a schematic that demonstrates how this cost-shifting occurs.

We also recommend limiting the size of net metering facilities and eliminating so-called virtual net metering – an abuse which exacerbates the cost-shifting problem.

Conclusion

Pennsylvania's electric distribution companies have learned a great deal over the past several years in implementing the state's energy mandates. This experience has been invaluable in terms of learning about customer behaviors, market interactions and stakeholder outreach, as well as how best to efficiently and effectively run our programs.

In these challenging economic times, we believe now is the time to put our experience to use to enhance these state programs and save consumers hundreds of millions of dollars over the next decade, while still meeting our shared environmental objectives. Those are dollars that can grow businesses, create jobs or just put food on the table for Pennsylvania families.

We commend the Committee for undertaking this review. Thank you for the opportunity to testify on this important issue, and I would be pleased to take any questions.