

Alliance to Save Energy
American Council for an Energy-Efficient Economy • Anacostia Watershed Society
Chesapeake Bay Foundation • Chesapeake Climate Action Network
Clean Water Action • The Cleanup Coalition • Maryland Conservation Council
Maryland Public Interest Research Group • Natural Resources Defense Council
Northeast Energy Efficiency Partnerships, Inc.

January 14, 2003

Catherine I. Riley
Chairman
Public Service Commission of Maryland
William Donald Schaefer Tower
6 St. Paul Street, 16th Floor
Baltimore, MD 21202

Re: Case No. 8908: Standard Offer Service after the End of the Rate-Freeze Period

Dear Chairman Riley:

We are writing to register deep reservations about the proposed Settlement Agreement intended to govern Standard Offer Service (SOS) for retail electric customers in Maryland following the end of the rate-freeze period. ***We urge the Commission not to approve this Settlement Agreement in its present form.***

Electric power generation has major impacts on Maryland's environment.

Public health and environmental quality in Maryland remain at risk from the emissions of power plants. A large portion of Maryland, including the entire Baltimore-Washington Metropolitan Area, remains designated as a serious or severe ozone non-attainment area. Health-threatening air pollutants, gasses that contribute to global climate change, and excess nutrients entering Chesapeake Bay are all byproducts of fossil fuel combustion in power plants. Investments in energy efficiency and renewable energy can help reduce these emissions. However the Settlement Agreement will discourage development of these clean energy resources.

Conventional power generation resources bear unexpected, higher risks.

Since Maryland's restructuring legislation was enacted in 1999, several assumptions driving this policy have proven alarmingly incorrect. First, it was assumed that private, unregulated companies would supply all needed power generation through the invisible hand of the marketplace. Second, it was assumed that power prices would generally fall under restructuring. Third, it was assumed that sophisticated risk-management methods, such as the trading and derivatives markets developed by Enron and others, would keep prices stable. Recent developments have seriously undermined these assumptions.

Bankruptcies and credit downgrades are sweeping the unregulated power industry, including companies active in Maryland. Plant cancellations and delays have mushroomed: non-utility generators were scheduled to provide 86% of new capacity in 2002, but 70% of that has been delayed or cancelled¹, including more than 2000 MW of planned capacity cancelled in Maryland this year alone. Since 1999, power prices have often run substantially higher than historical levels, forcing most competitive power marketers out of Maryland and other PJM states. Finally, in the last year electricity trading and related derivatives markets have collapsed, leaving utilities and customers alike increasingly exposed to price volatility in electricity markets.

Energy efficiency and renewable energy offer cost-effective, practical risk-management options for Maryland's electricity portfolio. They are, in essence, modest-cost insurance policies against higher prices and power outages. To embrace a settlement that omits these options is bad business and bad policy. We urge the Commission to expand its thinking and include serious energy efficiency and renewable energy components in any final order relating to matters covered by this Settlement Agreement.

The Settlement Agreement purposefully raises rates for retail customers and leaves price stability behind.

These comments are directed primarily toward the shortcomings of the Settlement Agreement as it applies to residential and small commercial (Type I) customers. Provisions applicable to large commercial customers are similar in nature, although specific details may differ.

The Settlement Agreement contains binding ground rules for the provision of electric service to the vast majority of retail electric customers in Maryland (those who have not switched electricity suppliers) during the four-year period that immediately follows the expiration of the rate-freeze period of each of Maryland's four investor-owned electric distribution companies. In brief, the Settlement Agreement requires that –

- The four incumbent electric companies will procure electric power for customers who have not switched electricity suppliers;
- This power procurement is to be undertaken in increments of short duration (at least 50% in one-year contracts) and at seasonally differentiated prices;
- No contracts are to extend beyond the four-year period, unless subsequently allowed or directed by the Commission;
- Power must be acquired as a fixed percentage of the incumbent electric companies' load, rather than in specific amounts of capacity or energy.

In addition to the price fluctuations that will result from short-term contracting, retail customer rates are to be increased by a so-called Administrative Charge of 4 mills for residential customers and 5.5 mills for small commercial customers, of which not less than 1.5 mills and 2 mills, respectively will be retained by the electric companies explicitly for the benefit of their stockholders.

The principal effect of these provisions appears to be to shield electric companies from the risks of fluctuating prices in the wholesale markets for electric power, transferring exposure to such risks to retail consumers trapped in recurring cycles of short-term purchases of power on their behalf.

The Settlement Agreement ignores energy efficiency.

Prior to electricity restructuring, Maryland had some of the most extensive energy efficiency programs in the nation supported by assessments on utility bills. At a cost of about a quarter cent per kilowatt-hour, or about \$1.80 per month for a typical residential customer, numerous energy efficiency programs were offered to customers. These programs were found to be saving over 2 billion kilowatt-hours of energy in 1998 – equal to about 3½% of total electricity sales – resulting in substantial pollution prevention and customer bill savings. But virtually all of these programs have been eliminated with Commission approval. Not surprisingly, electricity consumption in Maryland has grown as efficiency programs have wound down.² In 1999, most of the parties to this current Settlement Agreement entered into settlement agreements covering the terms of service for the rate freeze period for BGE and Allegheny Power. These 1999 agreements, approved by the Commission, made specific provision for energy efficiency programs for residential customers to be funded with 1 mill assessments on customer bills.³ Unfortunately, the Commission has not acted to implement the energy efficiency provisions of these prior settlements.⁴ What's more, the companies' commitments to these programs will expire with the end of their respective rate freeze periods. ***The proposed Settlement Agreement makes no provision to maintain or extend the previous commitments of utility companies to implement cost-effective energy efficiency – commitments which will soon sunset – even as it incorporates specific provisions to raise the rates of retail customers.***

With the Commission having failed to initiate energy efficiency programs where agreement to do so was already established, Maryland's consumers have been left without the help they will increasingly need to manage their energy bills in the future -- and the state will endure an additional measure of powerplant pollution that is wholly unnecessary. Additionally, by structuring power purchases in a series of short-term contracts that essentially absolve utility companies from either price or supply risk, the Settlement Agreement further diminishes the incentive for these companies to support investments in energy efficiency.

By limiting its focus to the short term and exacerbating the risk of price volatility to customers, the Settlement Agreement as currently drafted places customers in a double bind. On the one hand, prices may go up, encouraging customers to invest in efficiency, but offering no use-friendly mechanisms to save energy cost-effectively. On the other hand, prices may also fall in some years. In this uncertain environment, few customers will make substantial efficiency investments. This creates yet another barrier to energy efficiency, which can only be overcome via policy and program intervention. To keep the risks of price volatility, demand spikes, and blackouts to a minimum, the Commission needs to ensure that energy efficiency and renewable energy are promoted actively and in

a sustained fashion in Maryland's electricity portfolio as part of a responsible Settlement Agreement.

The Settlement Agreement leaves renewable energy for last.

Item 28 on the list of 28 issues deferred for discussion during Phase II of settlement negotiations is the "consideration" of renewable product offerings to retail customers. While it is certainly worthwhile to provide all retail customers in Maryland the opportunity to purchase electricity from renewable sources, the overall architecture of Phase I of the Settlement Agreement ensures that renewable energy will remain a costly niche product for the foreseeable future, for at least two reasons.

First, the Settlement Agreement's predilection for one-year, two-year, and three-year contracts (mostly one-year) make it virtually impossible for new renewable projects to bid successfully in response to the utilities' RFP's for electricity to supply their Standard Offer Service customers. Multimillion dollar projects cannot be financed on the strength of a one-year contract, especially relatively capital-intensive renewable energy projects. Additionally, the Settlement's requirement that bidders must supply a fixed percentage of the utilities' SOS load works to the disadvantage of small renewable projects that might otherwise bid in a fixed amount of energy and/or capacity.

Second, discussion of renewable energy frequently turns on the cost premium when compared with traditional sources of power generation. However, a key *benefit* of renewable energy (quite apart from its environmental attributes) is its role in a diverse portfolio as a hedge against price volatility in wholesale markets over time. Renewable energy is produced either by fuel without cost (solar, wind) or by other fuels (wood chips, poultry litter) not tied to the supply-demand imbalances and geopolitical risks of traditional fossil fuels. The longer the term of the contract, the more valuable this ability to hedge will be. By sharply limiting the duration of contract terms, the Phase I Settlement Agreement will strip renewable energy of a key competitive advantage and stack the deck against the development of new renewable energy projects to serve Maryland's SOS customers.

Recommendations

For the reasons above, and for the many additional benefits of energy efficiency and renewable energy identified by the Commission itself in prior reports to the Maryland General Assembly, **we recommend that the Commission *not* accept the Settlement Agreement in its present form**, but rather remand the proposal back to the settling parties with specific direction to:

- ❖ modify the provisions governing Model Bid Plans to --
 - allow at least 30% of load to be served by contracts of 10 or more years' duration;
 - establish a minimum percentage of power that must be derived from clean renewable sources of energy in each calendar year covered by the plan;

- allow small project suppliers to offer load blocks expressed as fixed amounts of energy and/or capacity; and
- take into account the bidders' environmental attributes as well as other relevant factors.

AND

- ❖ Renew and broaden the provisions of previous settlement agreements to establish energy efficiency programs for all Maryland retail customers served by Standard Offer Service. Consistent with previous agreements, a minimum of one mill per kilowatt-hour should be collected in a Public Benefit Fund and used to support cost-effective energy efficiency programs that will benefit customers.

We believe these additions and revisions to the Settlement Agreement are essential to protect the public interest in the manner in which electric service is provided to most consumers in Maryland. If the Commission finds that it cannot design a more rational framework for Standard Offer Service under current law, we urge you to so inform the Governor and the General Assembly at the earliest practical opportunity.

Sincerely,

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cc: Senator Thomas E. Middleton, Chair, Senate Finance Committee
Delegate Dereck Davis, Chair, House Economic Matters Committee
Governor-Elect Robert Ehrlich
Settlement parties

The following documents are incorporated by reference into this submission:

- Harrington, Moskovitz, et al, *Portfolio Management: Protecting Customers in an Electric Market that Isn't Working Very Well*, Regulatory Assistance Project, July 2002;
- Travieso, Michael, Maryland People's Counsel, Testimony on S.B. 541, a bill to authorize an Energy-Saving Investment Program, before the Maryland Senate Finance Committee, March 19, 2002;
- Governor's Task Force on Energy Conservation and Efficiency, *Final Report*, December 15, 2001;
- Public Service Commission, *Report on Energy Efficiency and Conservation Programs (Demand-Side Management)*, February 2001;
- Public Service Commission, *Renewable Portfolio Standard Report*, 2000.

Replies to this letter may be directed to Gigi Kellett, Maryland Public Interest Research Group, 3121 St. Paul Street, Suite 26, Baltimore, MD 21218; tel: 410-467-0439; e-mail: gigikellett@juno.com.

¹ U.S. Department of Energy. Energy Information Administration. *Capacity Additions, Delays, and Cancellations*. <http://www.eia.doe.gov/cneaf/electricity/page/capacity/capacity.html>

² Statewide electricity sales *fell* by 1.3 % in 1997 from 1996 levels, while electricity sales *grew* by 2.2% in 1999 over 1998. In the residential sector alone, electricity sales *fell* by 4.6 % in 1997 from 1996 levels, while electricity sales *grew* by 4.2% in 1999 over 1998.

³ BGE Settlement (June 29, 1999) --

Subject to review and approval by the Commission, effective July 1, 2000, a public benefits surcharge may be imposed on residential customers to fund demand side management, renewable resources, and aggregation technical assistance. The surcharge shall not exceed 1.0 mill per kWh for residential customers. Any such surcharge has not been included in Appendix A. ***The program terminates July 1, 2006.*** The surcharge shall not apply to non-residential customers. The Settling Parties reserve all rights to protest or take any position on any filing made pursuant to this Paragraph. [Emphasis added.]

Allegheny Settlement (Sept. 23, 1999)--

Subject to review and approval by the Commission, effective July 1, 2000, a public benefits surcharge may be imposed on residential customers to fund demand-side management, renewable resources and aggregation technical assistance. The fund may also be used to extinguish any unrecovered balance of demand-side management costs for residential programs as of July 1, 2000. The charge shall not exceed 1.0 mil per kilowatt-hour for

residential customers, with 0.4 mil from the current Energy Conservation Surcharge and 0.6 mil per kilowatt-hour from Allegheny Power's capped rates through December 31, 2001.

After December 31, 2001, Allegheny Power may surcharge residential customers up to 1 mil per kilowatt-hour, with prior Commission approval. Any such surcharge has not been included in Attachment No. 2. ***The surcharge terminates July 1, 2006.*** The surcharge shall not apply to non-residential customers. [Emphasis added.]

⁴ Several of our organizations submitted joint recommendations for efficiency programs in the docketed proceeding conducted during 2000 and 2001 by the Commission on demand side management, Case No. 8738. In filings on June 9, June 30, August 28, October 18, and November 17, 2000, among others, we urged the commission to act to restore energy efficiency programs in Maryland. We filed detailed residential, commercial, and industrial program descriptions, and when the Commission sought additional information on the cost-effectiveness of such energy efficiency programs, we retained consultants and filed such information with the Commission.

Regrettably, the Commission chose not to fashion our recommendations into an order for the implementation of energy efficiency programs, but rather used them as a basis for its efficiency program recommendations contained in a Commission report to the legislature on March 1, 2001, *Report on Energy Efficiency and Conservation Programs (Demand-Side Management)*.