CleanEnergyGroup
Innovation in Finance, Technology & Policy

June 14, 2007

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515

The Honorable Rick Boucher
Chairman
Subcommittee on Energy and Air Quality
U. S. House of Representatives
Washington, DC 20515

Dear Congressmen Dingell and Boucher:

In response to your letter of May 24, 2007, requesting responses to questions regarding the possible enactment of "portfolio standards" legislation, Clean Energy Group (CEG) offers several observations on how interactions between state renewable portfolio standard (RPS) programs and a federal RPS might best be addressed from a state perspective. We believe that the potential for conflict between state RPS policies and a federal RPS is a key issue that must be resolved in any national portfolio standard legislation.

Clean Energy Group (CEG) is a national nonprofit organization working in the United States and internationally on technology, finance and policy programs in the area of clean energy. CEG also manages the Clean Energy States Alliance or CESA. CESA is a nonprofit state membership organization, incorporated in 2002, as a multi-state coalition of the leading state clean energy funds and programs working together to support and promote clean energy technologies.[1] CESA's state members have an important stake in the success of state RPS policies, as the state clean energy funds are sometimes the implementation agencies for RPS mandates; in other cases, the state funds play a critical role in supporting projects to satisfy RPS requirements.

CEG also has established and is facilitating a multi-state collaborative process of representatives from several Northeast and Mid-Atlantic states with RPS policies, including key state RPS administrators and regulators.[2] This interstate RPS collaborative is examining the challenges and potential solutions for successful implementation of state RPS programs. While the state-based collaborative takes no position on the merits of a federal RPS, the group is distilling lessons from state RPS experience that could be useful in the design of a federal RPS.

[1] For more information about CEG and CESA, see www.cleanegroup.org and www.cleanenergystates.org.
[2] Participants in the state RPS collaborative include NYSERDA, the California Energy Commission, the New Jersey Board of Public Utilities, the Massachusetts Technology Collaborative, the Massachusetts Department of Energy Resources, the New York State Public Utility Commission and the Connecticut Public Utility Commission.

Our comments focus primarily on state-federal interactions on portfolio standards. We take no position either endorsing or opposing a federal RPS. These comments should not be construed as an endorsement of federal RPS legislation. However, recognizing that federal RPS proposals are receiving serious consideration in Congress, we feel it is critical to present state concerns and perspectives on the possible interaction of federal and state RPS policies.

General Comments:

Recommended Principles Governing the Interaction between a Federal RPS and State Renewable Energy Policies

Renewables portfolio standards are an important tool that states are using to encourage clean energy investment in the U.S. Twenty-two states and the District of Columbia have adopted mandatory RPS policies. These states have significant experience with this policy approach—experience that the Congress should consider in drafting federal RPS legislation. Based on this extensive state experience and leadership, we offer the following general principles to guide how a federal RPS program might most effectively relate to state renewable energy policies.

- Federal legislation should not preempt the ability of states to establish their own RPS policies, which may differ from a federal RPS, though state RPS policies should not relieve retail electric suppliers of responsibility to satisfy federal requirements.
- A federal RPS should set only a floor, rather than a ceiling, allowing states to be more aggressive in requiring more renewable energy deployment than the national standard. States should be free to exceed the federal target, with the national standard only guaranteeing a minimum level of renewable energy development.
- Renewable energy credits (RECs) should be issued strictly on the basis of one credit for each megawatt-hour of eligible renewable energy generated.
- A federal RPS should coordinate with and build on existing state and regional certificate tracking systems to ensure national tracking for federal RECs and to address double-counting concerns.
- Whenever possible, effort should be taken to minimize implementation complexity, as well as legislative and regulatory ambiguity.

Response to Specific Questions

2. Portfolio Inclusions and Exclusions

a. What is the principle that should determine inclusion or exclusion of any energy source from the portfolio standard?
b. What generation sources should be included and excluded?
c. Should tiers be adopted?

A well-designed RPS requires clarity in eligibility rules (including technology, fuel, vintage, and location) so market participants can assess eligibility before making significant financial commitments. Eligibility rules should be well-defined and stable, and not subject to sudden change. Fuel, technology, and vintage eligibility decisions should be guided by an assessment of the social benefits of the particular resources and technologies, and by an evaluation of the need of those projects for extra-market revenue from an RPS.

We also recommend that customer-sited projects that otherwise meet the eligibility criteria qualify for the federal RPS and renewable energy applications that save electricity (such as geothermal heat) be provided with eligibility.

If a policy objective is to assure a certain level of resource diversity among the renewable energy technologies and fuels, the national legislation should consider (1) specific resource bands or tiers, (2) credit multipliers, or (3) complementary policy approaches.

4. Relationship to State Portfolio Standards and Utility Regulation

a. An adopted federal portfolio standard should allow States to set different or higher targets.

As there are now 22 states that have adopted mandatory RPS policies, it is important that this pioneering state work not be pre-empted by national RPS legislation. A federal RPS should not preempt or diminish existing or new state RPS policies. National legislation should not prohibit states from requiring more renewable energy than the federal standard through a state RPS. Such language should be clear and explicit in any national legislation. Otherwise, legislative ambiguity and uncertainty could stall the market for renewable energy. At the state level, the presence of uncertainty has been used as an excuse for inaction. The national legislation also should address the issue of "dual compliance" with state programs; that is, how to "count" state RPS compliance actions towards the federal RPS.

We offer the following suggestions for how to address these interaction, preemption and counting issues. We believe that the approach laid out below is simple to understand and implement, analytically sound, complete, and would not pose undue complexity. We also believe that it meets the dual objectives of (1) allowing states to develop their own RPS policies, while (2) ensuring that state RPS compliance actions will generally count towards the Federal RPS.

- Federal legislation should not restrict states in establishing their own targeted RPS policies. For example, state programs could include different rules about percentage requirements, resource eligibility, geographic location or electricity deliverability, obligated entities, required REC attributes, etc. None of these state policies should, however, relieve retail electric suppliers from meeting their federal RPS obligations.
- National legislation should ensure that renewable energy purchases made under state RPS requirements, *if those purchases meet the definitions and standards of the federal RPS,*

also *count towards the federal RPS*, but limited to the amount of the retail supplier's federal RPS obligations in that year.

- If a state RPS requires more renewable energy than the federal RPS (assuming the same eligibility requirements for both), renewable energy credits *in excess* of the federal requirement should be ***prohibited*** from being banked for future use, transferred or used in other states for federal compliance if they have been used for state compliance. This will ensure that RECs purchased for state RPS compliance can be generally counted towards the federal RPS, but will prohibit double counting since the "excess" federal RECs are not considered "excess" if they already have been used for state compliance.
- National legislation should ensure that only those RECs purchased for state RPS compliance that are ***also*** eligible under the federal RPS may be counted towards the federal RPS. State mandated purchases that are not eligible under the federal RPS (e.g., waste coal, energy efficiency, etc.) would not count towards the federal RPS.

b. National RPS legislation should respect the authority of state regulatory agencies to make decisions relative to cost recovery for compliance with portfolio standard requirements in retail rates.

We recommend that national RPS legislation confirm that state regulators are exclusively responsible for RPS cost recovery decisions, because states have authority over retail rates and are typically responsible for determining the prudence of utility electricity purchase decisions. State regulatory agencies should ***not*** be mandated to pass through all federal RPS compliance costs but allowed to apply standard prudency tests in making determinations of cost recovery. That is, national legislation should provide that all prudently incurred federal RPS compliance costs are recovered in electricity rates as determined by appropriate state regulatory bodies.[3]

At a minimum, national legislation should respect the states' continued authority to establish retail rates, cost recovery rules and prudency tests for utility compliance with state RPS policies, even if REC purchases under these policies also may count towards the federal RPS.

5. Utility Coverage

a. Should any retail sellers of electricity be exempt from the portfolio requirement?

We recommend that the federal RPS apply to all retail power providers including investor-owned utilities, publicly-owned utilities, municipalities, and rural electric cooperatives. A well designed RPS would ideally apply equally to all load-serving entities, ensuring that all those who benefit from increased renewable energy production also bear a proportion of the costs.

[3] In a regulated market or for providers of last resort, state regulators would deem expenditures prudent through oversight of the procurement process. In competitive markets, the dynamics of competition will provide automatic discipline on pricing; if suppliers incur imprudent costs, they automatically risk incomplete recovery of costs.

In many states, retail electricity competition now allows non-utility competitive suppliers to provide electricity at retail. In such states, the state RPS regulations apply to these suppliers of retail load. We recommend, therefore, that the federal RPS apply to all providers of retail electricity including competitive providers.

6. Administration and Enforcement

a. Should the federal government enforce the RPS requirement?

b. How should federal and state enforcement be coordinated?

c. What penalties should apply?

An effective RPS must be enforceable, ensuring that the policy's targets are achieved. Clear rules for enforcement should be established, providing confidence to renewable energy developers that electricity suppliers will make their required purchases.

We also suggest that financial compliance mechanisms (alternative compliance payments, penalty payments, etc.) at the state level be considered acceptable for federal RPS compliance. Penalties paid to states for state RPS noncompliance could be made deductible from any federal penalty that might be owed, on a dollar-for-dollar basis. (These payments only would apply in the year made and could not be banked for future use against a federal alternative compliance payment). However, only state payments that are based on failure to meet a state RPS would qualify; ACPs/penalties paid for lack of compliance with state standards that strictly apply to energy efficiency or to non-renewable technologies would not qualify under this provision. This approach would significantly reduce complexity and the need for difficult regulatory decisions.

7. Credits and Trading

a. Should tradable credits for qualifying generation be utilized as the mechanism for establishing compliance?

Yes. Many state RPS programs use tradable renewable energy credits to increase flexibility and reduce the cost of compliance with the purchase mandate and to facilitate compliance tracking.

Tradable credits have many advantages. The use of RECs can provide an accurate, verifiable record of what was produced and a fungible commodity that can be traded among suppliers. RECs also can reduce the cost of RPS compliance by lowering transmission costs while providing access to a broader and greater range of resource options. RECs further provide compliance flexibility by facilitating market trading and increasing market liquidity.

State REC definitions vary substantially and states should retain the flexibility to develop their own REC definitions. However, national legislation that provides a simple, standard definition for federal RECs can lay the foundation for well coordinated markets and policies. RECs will be

fungible for national RPS compliance and support a liquid market ***only if*** they have a clear and common definition.

Therefore, we recommend that any national legislation include a concise definition for the renewable energy attributes represented in federally compliant REC purchases. We recommend the most universal definition of a REC, based on a unit of production – 1 MWh = 1 REC. RECs should contain information on the primary attributes of the generator including: vintage, size, resource type, direct emissions, location, etc.

b. Should credit trading be permitted or required on a national basis in order to achieve least-cost compliance?

Yes. We believe that the federal goal should be to establish a seamless national REC trading and tracking system out of the pre-existing state and regional tracking systems, rather than developing a separate and additional federal REC tracking system. Both state RPS requirements and a federal portfolio standard require REC tracking systems. However, duplication of REC issuing, tracking and retiring with various regional and state certificate tracking systems could add costs to market participants, unnecessarily increase complexity, and increase the chance of double counting.

Existing state/regional REC tracking systems currently operate in New England, the region served by PJM, and the states of Texas and Wisconsin. Tracking systems are currently under development in the West (near operational), the upper Midwest, and New York. Although these systems differ from region to region, they all have in common the responsibility to issue certificates based on verified eligible generation, track ownership as RECs are traded among market participants, and retire certificates as they are used for RPS compliance. These systems are able to accommodate the diversity of state RPS requirements that already exist, and could be expanded to cover federal RPS compliance tracking as well. We see little benefit to having a separate tracking system for federal RPS compliance, and believe that such an approach would impose undue complexity and costs.

Integration of these existing tracking systems on a national basis could be accomplished by directing the Department of Energy to:

- Coordinate with these existing and emerging regional and state tracking systems and to delegate tracking responsibility for the federal RPS to these same tracking systems. In coordinating and leading this activity, we also recommend that DOE consult with a tracking system advisory group, such as the North American Association of Issuing Bodies.[4]
- Ensure that regional tracking systems meet certain functionality requirements that enable and facilitate the national trading of RECs, reducing seams issues, and allowing DOE to pre-empt existing regional systems if those systems do not meet the functional requirements established by DOE.
- Create one or more tracking systems to serve states lacking such a system.

[4] More information on the North American Association of Issuing Bodies is available at http://www.resource-solutions.org/policy/naaib/index.htm.

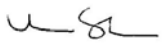
e. What relationship, if any, should portfolio standard credits have to other state and federal credit trading programs?

The interaction of RPS policies and renewable energy markets with emission regulation and markets today leads to considerable confusion. Therefore, a federal REC should not include derived attributes such as emission reduction credits or allowances. However, states should continue to be allowed to decide whether or not such derived attributes must be attached to the basic REC for state RPS purposes. In this manner, as long as a state-eligible REC also meets the minimum national standard, then it could also be used to count towards the federal RPS.

Conclusion

As Congress discusses the merits and design of federal RPS proposals, one important design element should be addressed – how such a federal standard will interact with the pre-existing state RPS policies. CEG strongly recommends that a federal RPS program not pre-empt state RPS programs but instead coordinate to the extent practicable with state programs. We are prepared to provide more information to Congress on these matters, upon request. We are available to meet with staff and/or with other major stakeholders to explain our recommendations.

Sincerely,



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