

**BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND**

IN THE MATTER OF THE COMMISSION'S	*	
INVESTIGATION OF INVESTOR-OWNED	*	
ELECTRIC COMPANIES' STANDARD	*	CASE NO. 9117
OFFER SERVICE FOR RESIDENTIAL AND	*	
SMALL COMMERCIAL CUSTOMERS IN	*	
MARYLAND	*	

IN THE MATTER OF WHETHER	*	
NEW GENERATING FACILITIES	*	
ARE NEEDED TO MEET	*	CASE NO. 9214
LONG-TERM DEMAND FOR	*	
STANDARD OFFER SERVICE	*	

**THE OFFICE OF PEOPLE'S COUNSEL'S
RESPONSE TO THE GOVERNOR'S COMMENTS**

On December 18, 2009, the Maryland Energy Administration ("MEA") filed the "Comments of Governor Martin O'Malley" ("Governor's Comments") in the above-referenced dockets. The Office of People's Counsel ("OPC") concurs with the Governor that the deregulation of the Maryland electric industry in 1999 has not delivered the benefits promised to residential customers when it was adopted. Deregulation eliminated much of the Commission's authority over electric supply decisions. However, to a large extent that regulatory authority was restored in 2006 by the passage of Senate Bill 1 (Chapter 5, Acts 2006 Sp. Sess.) and, as the Governor notes, the Commission has broad authority to take action with respect to the portfolio of assets used to provide electric service to Maryland customers.

Senate Bill 1 gives the Commission explicit authority to "require or allow an investor-owned electric company to construct, acquire, or lease, and operate, its own generating facilities, and transmission facilities necessary to interconnect the generation facilities with the electric

grid, subject to appropriate cost recovery.”¹ Senate Bill 1 also implemented a new standard for procurement of electricity for standard offer service (“SOS”). The law now requires that SOS be “designed to obtain the best price for the residential and small commercial customers in light of the market conditions at the time of procurement and the need to protect these customers from excessive price increases.”² Further, the procurement of electricity for SOS must be a “portfolio of blended wholesale supply contracts of short, medium, or long-term and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner.”³

OPC also concurs with the Governor’s concerns with the current portfolio of supply used for standard offer service for residential customers. The current portfolio approach for SOS power is basically the same one that has been in place since 2004. This approach has never been found to satisfy the requirements of Senate Bill 1.⁴ Further, the current approach was adopted by the Commission in 2006 as a balance of the interests of customers and the interests of the competitive market and not solely as the best possible approach for customers.⁵

Senate Bill 1 established two basic questions for the Commission: 1) could SOS be made to be a better service for customers and 2) would it be beneficial to consumers for utilities to acquire or build generation facilities on the customers’ behalf? These questions have not yet been answered. However, based on reports received by the Commission, which will be discussed later in these comments, there is strong reason to believe that the answers to both questions will be yes.

¹ Section 7-510(c)(6).

² Section 7-510(c)(4)(ii)(1).

³ Section 7-510(c)(4)(ii)(2).

⁴ The latest order on the procurement method is Order No. 81102, issued on November 8, 2006 in Case No. 9064. *Re Competitive Selection of Electricity Supplier/Standard Offer or Default Service for Investor-owned Utility Small Commercial Customers*, 97 MD PSC 384 (2006) (“Order No. 81102”). In that order, the Commission restricted its consideration to procurement alternatives that could be implemented in only a few months. *Id.* at p. 387. The Commission stated that it would review all possible procurement alternatives in a companion case, Case No. 9063. *Id.* The Commission never issued an order in that docket and recently closed it.

⁵ *Id.* at p.398, 401.

The Commission has been through a number of rounds of debate on the subject of the portfolio used by utilities to serve customers. Shortly after the passage of Senate Bill 1, the Commission docketed Cases No. 9064 and 9063 to address the question.⁶ Case No. 9064 was docketed to decide what type of procurement the utilities would use for power supply needed as of the summer of 2007, while Case No. 9063 was docketed to consider the supply portfolio to be used thereafter.⁷

The Commission held hearings in both cases in the fall of 2006. There was extensive debate on the subject of the SOS portfolio and how it interacts with retail competition. However, the debate was held at the theoretical level. No analysis of the expected cost of various supply portfolios (or the risks associated with them) had been done. The witnesses testified on the basis of economic theory and provided their opinions on the policy issues concerning retail choice and the relationship between SOS supply and retail competition. On November 8, 2006, the Commission issued Order No. 81102 in which it adopted the current SOS portfolio approach. This approach is very similar to the portfolio adopted in Case No. 8908 for implementation in 2004 when the first rate freeze ended.⁸ The fundamental aspects of the SOS procurement methodology in place since 2004 – the exclusive use of short-term (three-year or less) full requirements contracts – were not changed in Order No. 81102 and remain in place today.

⁶ “Order Instituting Proceeding,” May 10, 2006, Case No. 9063, *In the Matter of the Optimal Structure of the Electric Industry in Maryland*; “Order Instituting Proceeding,” May 10, 2006, Case No. 9064, *In the Competitive Selection of Electricity Supplier/Standard Offer or Default Service for Investor-Owned Utility Small Commercial Customers and Allegheny Power, Delmarva Power and Light and Potomac Electric Power Residential Customers*.

⁷ *Id.*

⁸ The most significant changes directed by Order No. 81102 were that the procurement was to be held twice a year approximately six months apart, as opposed to a once-a-year process which was broken into three parts to be conducted over three months; that all contracts would be two-years in length as opposed to one, two and three years; and that half of the contracts would begin service on October 1 instead of all of the contracts beginning service on June 1. Order No. 81102, p. 402-3.

In Order No. 81102, the Commission expressly stated that it was only considering supply options that could be put in place between November 2006 and June 2007.⁹ This restriction had the practical effect of limiting the possible supply options to some variant of the full-requirements contracts in use at the time. The Commission stated that it would consider the wider universe of supply options in Case No. 9063.¹⁰ Further, The Commission made its decision as a result of balancing a number of factors instead of having the sole focus of providing the best price with reasonable protection from volatility. The Commission found that the objectives of best price and price stability had to be “harmonized with the overall goals of the 1999 Act to ‘establish customer choice of electric supply’ and ‘create competitive retail electric supply and electric supply services markets.’”¹¹ Further, the Commission found that the goal of creating “competitive retail electricity supply services markets,” was a “*primary* objective of Maryland’s electricity procurement structure” and, thus, had to be balanced on equal footing to the recent amendments comprising Senate Bill 1 as they pertain to SOS pricing.¹² The Commission found that its role was “to fashion SOS procurements that *simultaneously*: 1) *advance retail competition and customer choice*; 2) achieve the best price for customers receiving SOS; and 3) mitigate against excessive volatility.”¹³ OPC argued in its “Request For Rehearing And Reconsideration And Motion For Expedited Consideration,” filed on December 5, 2006 in Docket No. 9064, that the Commission had erred in its interpretation of the statute because after Senate Bill 1, achieving the best price with appropriate protection from volatility are the only valid considerations for designing SOS procurement and those goals cannot be

⁹ Order No. 81102, p. 387.

¹⁰ *Id.*

¹¹ *Id.* at p. 398.

¹² *Id.* at p. 401 (emphasis added). The Commission restated the concern posited by retail supply companies that longer-term procurement for SOS is harmful to their business model. *Id.*

¹³ *Id.* at p. 398 (emphasis added).

compromised to achieve a higher level of retail switching or to benefit retail suppliers. That request was never ruled on. The Commission also did not issue an order in Case No. 9063.

The Commission docketed Case No. 9117 on August 16, 2007, to investigate the utilities' SOS portfolio for residential and small commercial customers. In its "Order Initiating Proceeding," the Commission recognized that "[a]lthough the Commission has approved and supervised the process utilized in past SOS supply bids, it may be that other approaches could produce better prices than the current approach." Order No. 81563, p. 1.

The Commission held hearings in this case in the fall of 2007.¹⁴ Again, no analysis of costs or risks of various alternatives for SOS supply and diversified portfolios were presented to the Commission. Recognizing the lack of analysis in the record to that point, the Commission issued Order No. 82105 in Case No. 9117 on July 3, 2008, which directed the utilities to perform certain analyses and make a recommendation of the portfolio which best meets the statutory standard adopted in Senate Bill 1. In Order No. 82105, the Commission cited the report entitled "Part I: Options For Re-regulation And New Generation" that included, among other things, an "Analysis Of Options For Maryland's Energy Future" prepared by Kaye Scholer LLP, Levitan & Associates, Inc., and Semcas Consulting Associates (the "Levitan Report") that the Commission submitted to the General Assembly in response to Senate Bill 400 of 2007 and a report commissioned by OPC by Resource Insight, Inc. and Synapse Energy Economics, Inc. entitled "Risk Analysis Of Procurement Strategies For Residential Standard Offer Service" (the "OPC Risk Analysis").¹⁵ These studies analyzed the costs and benefits associated with different supply options for electricity service in Maryland. The Levitan Report and the OPC Risk Analysis come to the same basic conclusion: that it is reasonable to expect that there are supply

¹⁴ There was a final day of hearings on January 8, 2008.

¹⁵ The OPC Risk Analysis was filed with the Commission on May 8, 2008, in Public Conference 13, *In The Matter Of Senate Bill 400 Reports*.

alternatives, and combinations of those alternatives, that would provide value to customers compared to the current procurement approach of simply accepting the prevailing short-term market prices.

The utilities made the filings directed in Order No. 82105 on October 1, 2008. The utilities recommended that the Commission maintain the current SOS portfolio with the caveat that the Commission could change the portfolio from a laddered set of two-year contracts to a laddered set of three-year contracts. The Commission directed interested parties to file comments on those filings. OPC's comments pointed out that utilities' did not analyze the costs and benefits of various diversified portfolios, as directed by the Commission, but instead, compared discrete resource options to the full-requirements contracts approach. The utilities did not present an analysis of the three-year laddered contract approach that they recommended the Commission adopt. Further, OPC's evaluation of the utilities' analysis showed that they actually supported the conclusion that inclusion of longer-term supply resources would provide customers with lower costs and less risk.¹⁶ The Commission has not issued a decision in the case.

It is incumbent on the Commission to move expeditiously toward a resolution of both of the questions presented by Senate Bill 1. Given the importance of these questions, the Commission needs to establish procedures to provide it with the necessary information and analysis to arrive at sound and well-documented decisions. The most efficient way to reach a decision on these two issues is to commence two procedural tracks, one for each of the issues, which would proceed simultaneously. The next step toward deciding if SOS can be made better – and actually making it better – is to direct the investor-owned utilities to issue a broad request for proposals (“RFP”) for supply options and establish a process for evaluation and acceptance of

¹⁶ “Comments of the Office of People’s Counsel,” Public Conference 13, May 8, 2008, p. 9. 14.

some (or none) of those proposals. While that RFP process is underway, the Commission should move forward on a second track with a process for answering the second question: whether it would be beneficial to customers for Maryland utilities to acquire or build generation facilities on customers' behalf. Below OPC provides more detailed comments on each of these tracks.

Process for SOS Portfolio Analysis and Implementation

As discussed above, the debate over the make-up of the portfolio of assets used to supply customers has been based on arguments regarding hypothetical supply alternatives intermixed with policy debate. To move toward answering the question of whether the SOS portfolio can be improved, the Commission should take the debate out of the realm of the hypothetical and into analysis of actual supply opportunities. The way to do this is to direct the utilities to issue an RFP that is open to many types of supply, the results of which can be analyzed to determine whether these actual supply resources can be assembled into a portfolio that is superior in terms of cost and risk to the current supply portfolio. In Case No. 9214, *In The Matter Of Whether New Generating Facilities Are Needed To Meet Long-term Demand For Standard Offer Service*, the Commission has begun a process which could be used to determine whether the SOS portfolio can be improved. However, Case No. 9214 has a narrow perspective as it seeks only proposals for new generation. Further, it takes an intermediate step of asking for potential developers to file expressions of interest and general project information. Instead, the Commission should move more directly to an actual RFP issued by the utilities that would solicit proposals for a broad range of supply options. Contracts with new construction could still be part of the SOS RFP process but would also be the focus of the second track, which is discussed in more detail below. A broad RFP would allow for an evaluation of real proposals to determine which

proposals, or combination of proposals, would benefit customers and to provide for an expeditious implementation of proposals that are found to be beneficial.

The evaluation of a diversified portfolio, and implementation of the portfolio that is found to be beneficial, can be most efficiently accomplished at this point by directing the utilities to issue broad RFPs that would seek complete proposals for a wide variety of supply resources. The types of resources solicited in the RFP should include not only new generation plant but also other supply resources, such as existing generation plant, renewable resources, demand response or energy efficiency resources, or physical or financial contracts for the supply of capacity or energy for various lengths of time.¹⁷

The RFP process is a complicated technical task and OPC believes that it would be aided by involvement of an experienced consultant who is selected by and works for the Commission. OPC recommends that the process begin with a short working group effort tasked with developing the RFP itself and making a recommendation for the process by which the resulting proposals would be evaluated. This working group could be led by the Staff with the assistance of the Commission's consultant and include all interested parties, including OPC, Type I customer representatives, other State agencies (such as the Maryland Energy Administration and the Department of Natural Resources), the utilities, and potential suppliers. The working group would recommend a draft RFP and an evaluation protocol to the Commission for review and approval.

The evaluation process would occur after the submittal of proposals. It is OPC's opinion that the evaluation process should include a period after the proposals are submitted during

¹⁷ In the "Comments Of The Office Of People's Counsel," filed October 30, 2009, in Case No. 9214, p. 3, OPC recommended that the Commission review the ongoing process before the Connecticut Department of Public Utility Control, Docket No. 06-01-08RE03, concerning a utility RFP for longer-term supply resources for standard offer service. More information about the RFP process undertaken by one of the Connecticut utilities is available at <http://www.uinet.com/uinet/connect/UINet/Power+Procurement/RFP+for+Long+Term+Contracts/>.

which the Commission's consultant would evaluate the expected costs and associated risk for the various resources and develop a recommendation for the SOS portfolio that best meets the statutory standard of "best price" and protection from "excessive price increases..." This recommendation would be filed with the Commission for review and approval. The Commission could establish a timeline for the RFP process that could result in a decision on new supply resources in approximately six months.¹⁸

Process For Evaluating Utility Ownership of Generating Plant

The second question – whether it would be beneficial for customers for the utilities to acquire or build generation facilities – requires an analysis comparing the expected costs, benefits, and risks associated with a plant owned by the utilities (or owned by a non-utility but compensated on a cost-of service basis) and the expected costs, benefits, and risks of relying entirely on the market to supply electricity for Maryland. To begin the second track for answering the questions presented by Senate Bill 1 in 2006, the Commission should direct the Integrated Resource Planning Division of the Staff to convene a work group to frame the modeling effort to compare the alternatives. This would include the development of modeling inputs, such as construction costs for various types of plants, costs recovery requirements for utility ownership, and ranges of future market prices with and without the addition of new utility plant. Various renewable resources should, of course, be evaluated as part of the analysis. The group should also explore the alternative ownership, contractual, and operating arrangements

¹⁸ The Commission should bear in mind that the current RFP for full-requirements contracts for SOS service covers procurement through October 2010. Under the current methodology, the next RFP for SOS supply would include a procurement in October 2010 for contracts with power delivery starting in June 2011 and ending in May 2013.

that could be used, such as an RFP process for bids to build a plant, that could be used and may provide benefits for customers.

It would be beneficial to have a neutral party to do the modeling of the costs and risks of various scenarios and to participate in the development of modeling inputs. Again, an experienced consultant working for the Commission as part of this process would provide this type of assistance. While this process would take a number of months to complete, it could be close to completion at the time the RFP for SOS supply is completed. The results of the RFP process for SOS supply would provide valuable information for the evaluation of the second question and could be incorporated into the analysis. Thus, a report of this working group could be presented to the Commission shortly after the completion of the RFP process. This report would provide a foundation for a discussion of the State's goals and policies with respect to new generating plant and a means for testing the impacts on consumers of implementing various policy goals. The report, along with hearings on the report, would form a solid basis for the Commission taking action (or not taking action) with respect to utility ownership of generation plant.

Conclusion

OPC concurs with the Governor that the Commission should move forward under its existing statutory authority to make decisions on the SOS portfolio and on whether it would be beneficial to customers for a utility to build or acquire new generation on the customers' behalf. These are not easy questions and they should be approached in a manner that will provide a sound analytical basis for the decisions made, whether or not those decisions make changes in the status quo. The foregoing comments are OPC's recommendations on how to proceed to

decisions on these critical issues. While the Commission's role with respect to these issues was less than clear after deregulation, the Commission's role, and responsibility, to ensure that the mix supply options used to serve Marylanders provides the maximum benefit to *customers* possible was made clear by Senate Bill 1 and the Commission should take action to carry-out that role.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 15th day of January, 2010, the foregoing Comments of the Office of People's Counsel was either hand-delivered, sent regular mail or sent via e-mail to all parties of record in Case Nos. 9117 and 9214.

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