PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA
1325 G STREET N.W., SUITE 800
WASHINGTON, D.C. 20005

ORDER

April 9, 2020

FORMAL CASE NO. 1017, IN THE MATTER OF THE DEVELOPMENT AND DESIGNATION OF STANDARD OFFER SERVICE IN THE DISTRICT OF COLUMBIA, Order No. 20327

I. INTRODUCTION

1. By this Order, the Public Service Commission of the District of Columbia ("Commission") adopts the 95/5 Model of cost recovery for the pilot program to procure renewable energy through a long-term power purchase agreement ("PPA") for electricity for a target quantity of five (5) percent of the Standard Offer Service ("SOS") load; establishes the margin that the Potomac Electric Power Company ("Pepco" or "Company") as the SOS Administrator will receive as the counterparty to the PPA; and requires that the Tier One Renewable Energy Credits ("RECs") generated by the PPA be retired to meet a portion of the annual Renewable Energy Portfolio Standard ("RPS") obligations of all SOS electricity suppliers. The Commission directs Pepco to file a revised request for proposals ("RFP") and a draft final agreement, consistent with this Order, within 30 days of the date of this Order. Consistent with paragraph 40, in the event Pepco receives any information from Standard & Poor's or any other credit rating agency regarding the impact of the long-term PPA on its financial condition, Pepco shall update the Commission within 15 days of receiving such information. In addition, the Commission will issue a Notice of Proposed Rulemaking in the *D.C. Register* amending the Commission's Standard Offer Service rules, consistent with this Order. The Commission anticipates that the RFP for the PPA will be issued by Pepco in September 2020, and that energy from the PPA will begin to serve the target quantity of five (5) percent of SOS load on June 1, 2024.

II. BACKGROUND

2. By Order No. 19897, the Commission, *inter alia*, established "a pilot program to procure renewable energy through long-term power purchase agreements for electricity generated by solar or wind power facilities located within PJM with a target quantity of five (5) percent of the SOS load."[1] In order to facilitate the establishment of this pilot program, the Commission directed that "a planning meeting be scheduled within 30 days, and that the SOS Working Group produce, by July 31, 2019, an RFP for long-

[1] *Formal Case No. 1017, In the Matter of the Development and Designation of Standard Offer Service in the District of Columbia* ("*Formal Case No. 1017*"), Order No. 19897, released April 12, 2019 ("Order No. 19897"), ¶ 1.

term renewable energy PPAs, including the renewable energy credits associated with the energy… and draft revised SOS rules, if required, to accommodate this change in the SOS procurement portfolio."[2] The Commission, in Order No. 19897, also directed Pepco to file an analysis regarding the impact of long-term renewable energy PPA obligations on imputed debt.[3] On May 28, 2019, Pepco filed its response.[4]

3. The SOS Working Group held three meetings on May 1, June 7, and July 11, 2019.[5] On July 31, 2019, Pepco, on behalf of the Working Group, filed a draft RFP; its comments addressing a number of issues affecting the PPA; and redlined edits to and comments on the draft RFP from Commission Staff, the Center for Renewables Integration ("CRI"),[6] the Apartment and Office Building Association of Metropolitan Washington ("AOBA"), the Sierra Club, and WGL Energy Services, Inc. ("WGL Energy").[7]

4. By Order No. 20232, the Commission solicited comments from interested persons regarding three issues affecting the integration of a long-term renewable energy power purchase agreement into the SOS procurement portfolio, Pepco's RFP, and the individual Working Group members' comments on the draft RFP.[8] Also in that Order, Pepco was directed to file an analysis indicating the approximate level at which long-term power purchase agreements represent a material credit and capital structure issue for Pepco, along with supporting calculations.[9]

5. Pepco filed its analysis on October 30, 2019.[10] AOBA, the District of Columbia Department of Energy & Environment ("DOEE"), the Office of the People's

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[2] Order No. 19897, ¶ 35.

[3] Order No. 19897, ¶¶ 37, 45 (citation omitted).

[4] *Formal Case No. 1017*, Potomac Electric Power Company's Response to Paragraph 37 of Order No. 19897, filed May 28, 2019 ("Pepco's Response to Paragraph 37").

[5] *See Formal Case No. 1017,* First Standard Offer Service Working Group Meeting Regarding Long-Term Renewable Energy PPAs Meeting Minutes, filed May 20, 2019; *Formal Case No. 1017,* Second Standard Offer Service Working Group Meeting Regarding Long-Term Renewable Energy PPAs Meeting Minutes, filed June 20, 2019 ("June 20th Minutes"); and *Formal Case No. 1017,* Third Standard Offer Service Working Group Meeting Regarding Long-Term Renewable Energy PPAs Meeting Minutes, filed July 23, 2019.

[6] CRI is a consultant for the District of Columbia Department of Energy & Environment.

[7] *Formal Case No. 1017*, Pepco's Response to Order No. 19897, filed July 31, 2019 ("Pepco's Response").

[8] *Formal Case No. 1017*, Order No. 20232, rel. October 10, 2019 ("Order No. 20232").

[9] Order No. 20232, ¶¶17, 22.

[10] *Formal Case No. 1017*, Pepco's Response to Order No. 20232, filed October 30, 2019 ("Pepco's Response to Order No. 20232").

Counsel ("OPC"), Pepco, and the Sierra Club filed comments on November 12, 2019.[11] On November 25, 2019, Pepco filed reply comments.[12]

III. DISCUSSION

A. Outstanding Issues Raised at Standard Offer Service Working Group Meetings

6. In Order No. 20232, the Commission invited comments on three issues for which a consensus could not be reached in the SOS Working Group meetings: 1) Which strategy/recovery mechanism should be employed to integrate the long-term renewable energy PPA into the SOS procurement portfolio?; 2) What margin or return should Pepco receive?; and 3) How should the RECs generated as a result of the PPA be treated?

1. Strategies/Cost Recovery Models to Integrate the Long-Term Renewable Energy PPA Into the SOS Procurement Portfolio

7. A key issue that arose during the SOS Working Group process was what strategy or cost recovery model should be employed regarding which customers pay for the energy purchased under the PPA and who consumes or buys that energy. Under the current SOS procurement regime, 100 percent of the SOS load is bid out as a full requirements product, requiring suppliers to provide not only the energy but also other components such as capacity, losses, congestion, load shaping, credit and risk, ancillary services, and the cost of compliance with the District's RPS.[13]

8. The SOS Working Group discussed three strategies or cost recovery models: 1) the 95/5; 2) Massachusetts; and 3) Pepco's proposed Modified 95/5. Under the 95/5 Model, the long-term renewable energy PPA provides the renewable energy to satisfy five (5) percent of the SOS load including the environmental attributes associated with that

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[11] *Formal Case No. 1017*, Comments of the Apartment and Office Building Association of Greater Washington ("AOBA's Comments"); Comments of the District of Columbia Department of Energy & Environment ("DOEE's Comments"); Comments of the Office of the People's Counsel ("OPC's Comments"); Comments of Pepco ("Pepco's Comments"); and Comments of the Sierra Club ("Sierra Club's Comments"), filed November 12, 2019.

[12] *Formal Case No. 1017*, Reply Comments of Pepco, filed November 25, 2019 ("Pepco's Reply Comments").

[13] June 20th Minutes at 4-5. "Full Requirements Service" is defined as meaning "all necessary Energy, Capacity, Transmission other than Network Integration Transmission Service, Ancillary Services, Renewable Energy Resource Requirement, transmission and distribution losses, congestion management costs, and such other services or products that are required to supply the Specified Percentage except for Network Integration Transmission Service and distribution service." *See Formal Case No. 1017*, Pepco's Proposed Wholesale Full Requirements Service Agreement ("WFRSA") and Request for Proposals for the 2019 to 2020 SOS Solicitation, WFRSA at 4 (Definition of Full Requirements Service), filed October 7, 2019.

renewable energy.[14] Pepco, as the SOS Administrator, would have to procure the remaining components for that five (5) percent – capacity, losses, congestion, load shaping, credit and risk, and ancillary services – and provisions would have to be made to accommodate the intermittent nature of the renewable energy provided by the PPA since the energy from the PPA will not strictly follow load demand.[15]

9. Under the Massachusetts Model, the current SOS procurement process remains unchanged since 100 percent of the SOS load would continue to be bid out as a full requirements service or product. The long-term renewable energy PPA would procure renewable energy, including the environmental attributes, equivalent to five (5) percent of the SOS load.[16] Under the Massachusetts Model, more energy is procured than is needed to serve the SOS load. Because the renewable energy procured pursuant to the PPA would not directly serve the SOS load, Pepco, as the SOS Administrator, would not have to procure the other components listed in paragraph 8.

10. Adopting the Massachusetts Model would mean that the cost of procuring the renewable energy equivalent to five (5) percent of the SOS load, including the environmental attributes, would be borne by both SOS customers and customers of competitive electricity suppliers. Since 100 percent of the SOS load would be procured as a full requirements product, the additional energy equivalent to five (5) percent of the SOS load generated from the PPA, would be sold into the wholesale market at a gain or a loss. The net proceeds from those sales would appear as sur-credits or surcharges on all ratepayers' bills depending on whether those sales result in gains or losses.[17]

11. Under Pepco's proposed Modified 95/5 Model, 95 percent of the SOS load would be bid out as a full requirements product, and the long-term renewable energy PPA would supply the remaining five (5) percent of the SOS load. The only difference between the 95/5 Model and the Modified 95/5 Model is who pays. Under the Modified 95/5 Model, both SOS customers and customers of competitive electricity suppliers would be responsible for all costs, whereas under the 95/5 Model, only the SOS customers are responsible for costs. According to Pepco, under the Modified 95/5 Model, it would not "act as a direct counterparty to the transaction…" but would, instead, "act as an agent,

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[14] "Environmental Attributes include Renewable Energy Credits ('REC') and any other federal, regional, state and other credits, certificates, benefits, emission reductions, offsets and allowances that are attributable, now or in the future, to the facility or the energy produced by the facility." Pepco's Response, Draft Request for Proposals at 3.

[15] Renewable energy, wind and/or solar systems, under a PPA, would not strictly follow the District of Columbia's SOS customers' load demand like the full requirements SOS product or service does. For example, solar energy is produced when the sun shines, and wind turbines turn when the wind blows. Provision needs to be made for the intermittent nature of solar and wind power generation not matching up with the constant and ever-changing nature of the District's SOS electricity demand and spot market purchases for electricity would make up for this mismatch.

[16] June 20th Minutes at 5.

[17] June 20th Minutes at 5.

collecting funds from customers in advance of paying the renewable developer, much like Pepco does for various taxes and surcharges it collects for the District of Columbia."[18]

12. AOBA prefers the 95/5 Model as it matches "cost causation and cost responsibility" by requiring SOS customers to bear the costs while receiving the benefits.[19] OPC supports the adoption of the Massachusetts Model as this model "collects funds from all ratepayers and hence treats all electricity suppliers symmetrically…" and, thus, spreads "the costs and benefits to all ratepayers."[20] The Sierra Club supports the adoption of the Massachusetts Model for the same reasons as OPC.[21]

13. DOEE notes that, if "the Commission finds that its preferred path forward is for the PPA to be procured *within* SOS, with benefits and costs accruing only to SOS customers, DOEE would strongly support that approach."[22] Given a choice between the 95/5 Model and the Modified 95/5 Model, DOEE prefers the 95/5 Model because with this model "the risks and benefits of PPAs procured to supply the SOS should be shared by SOS customers."[23] DOEE contends that, if the PPA was procured within SOS, "the benefits of accelerating the District's renewable energy and carbon reduction goals would be achieved."[24] DOEE reiterates its concerns raised previously in the SOS Working Group meeting that: 1) the Massachusetts Model does not follow the Commission's order of modifying the SOS product to include long-term PPAs for renewable energy; and 2) using the Massachusetts Model could not be a long-term solution to expand the purchase of renewable energy for SOS, because buying so much electricity in excess of the SOS load would be financially speculative and would not be prudent.[25] However, DOEE maintains that it can support the Massachusetts Model for the five (5) percent of SOS load procurement, subject to the condition that the Commission should find another way to procure renewable electricity PPAs for the SOS load when it decides to procure more than five (5) percent of the SOS load.[26]

14. In its Reply Comments, Pepco reiterates its preference for the Modified 95/5 Model whereby the risks and benefits of the PPA are shared by all ratepayers. Pepco also asserts that, "contrary to AOBA and DOEE's primary position, Pepco disagrees with

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[18] Pepco's Response at 4.

[19] AOBA's Comments at 3.

[20] OPC's Comments at 2.

[21] Sierra Club's Comments at 1. The Commission notes that Sierra Club's Comments are not paginated, so the page numbers are the Commission's additions.

[22] DOEE's Comments at 3 (emphasis in original).

[23] DOEE's Comments at 3.

[24] DOEE's Comments at 3.

[25] DOEE's Comments at 4.

[26] DOEE's Comments at 4.

limiting the costs to only SOS customers for two main reasons."[27] Pepco first argues that "the idea behind the long-term renewable PPA is to foster renewable development, which is tied directly to the District's clean energy goals."[28] Thus, in Pepco's view, "no single group – such as SOS customers – should be singled out and left to pay the costs related to this policy."[29] Pepco's second argument for not limiting the costs of the PPA to SOS customers is that "costs related to this Commission mandate will lead to negative ancillary consequences that may disproportionately affect low-and-moderate income Pepco customers."[30]

15. In its comments on the draft RFP, WGL Energy opposes adoption of the Massachusetts Model and a requirement that Pepco recover costs from all ratepayers.[31] According to WGL Energy, "100% of WGL Energy's mass market customers currently choose renewable suppliers exceeding RPS requirements" and "as such the WGL Energy customer already absorbs certain renewable energy costs at their preferred level of choice at minimum risk."[32] WGL Energy argues that it invests in renewable projects and PPAs "to support its various offers for customers and that these investments and programs would become distorted if the company is required to manage around the renewable component that is forced on its customers through long-term PPAs managed by the utility."[33]

DECISION

16. The Commission must decide which strategy or cost recovery model should be used to achieve the Commission's goal of integrating the long-term renewable energy PPA into the SOS procurement portfolio. As we indicated in Order No. 19897, while the risks associated with a long-term renewable energy PPA cannot be ignored, limiting this procurement to five (5) percent of SOS load minimizes these risks.[34] Both the 95/5 Model and Pepco's Modified 95/5 Model would accomplish the Commission's goal. Pepco's Modified 95/5 Model would spread the costs to all distribution customers and no commenter other than Pepco favored this cost recovery model. AOBA and WGL Energy argue that the Commission should adopt a cost recovery model that imposes costs on SOS customers who will receive the benefits of the SOS service. The Commission believes that since the SOS customers will receive the energy from the PPA, adopting the 95/5 Model is the most equitable option for procuring renewable energy through a long-term PPA. In addition, similar to the Modified 95/5 Model, adoption of the 95/5 Model furthers the goals

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[27] Pepco Reply Comments at 3.

[28] Pepco Reply Comments at 3.

[29] Pepco Reply Comments at 3.

[30] Pepco Reply Comments at 3.

[31] Pepco's Response, *see* WGL Energy's Comments to RFP at 1.

[32] Pepco's Response, *see* WGL Energy's Comments to RFP at 1.

[33] Pepco's Response, *see* WGL Energy's Comments at 1.

[34] Order No. 19897, ¶¶ 22, 32-33.

of *Clean Energy DC* to have at least one renewable energy power purchase agreement serve the SOS load and achieve a 50 percent reduction in greenhouse gas emissions by 2032 and is consistent with the 100 percent Tier One renewable energy standard for 2032 under the District's RPS program.[35] Finally, under the 95/5 Model, the cost of the PPA is borne by the SOS ratepayers who are incurring the costs.

17. As indicated in paragraph 8, under the 95/5 Model, Pepco, as the SOS Administrator, will have to procure the remaining components for the five (5) percent – capacity, losses, congestion, load shaping, credit and risk, and ancillary services – and provisions would have to be made to accommodate the intermittent nature of the renewable energy provided by the PPA since the energy from the PPA will not strictly follow SOS load. Once energy is delivered under the PPA which the Commission anticipates will be on June 1, 2024, Pepco, as SOS Administrator, shall file quarterly reports with the Commission detailing the costs it has incurred procuring the additional energy required to make up for the intermittent nature of the renewable energy (if needed) and the costs of procuring the remaining components described above. The details regarding the exact information that is to be reported by Pepco will be determined in a future Order or rulemaking procedure.

18. In addition, the Commission will hire a consultant within 90 days of the end of the first year that the PPA has provided energy to SOS customers to assess the benefits, costs, and risks to SOS customers. The Commission will also use this information to analyze the feasibility of expanding the percentage of the District's SOS load to be served by renewable energy PPAs beyond the initial five (5) percent. As we indicated in Order No. 19897, "[s]tarting small in this manner would help minimize risks to ratepayers associated with PPAs."[36] If we can minimize the risks to ratepayers, the Commission expects to expand the percentage beyond five (5) percent of the District's SOS load served by long-term renewable PPAs.

2. Margin or Return for Administering the PPA

19. The Commission established the margin as the mechanism to compensate Pepco for the risks associated with serving as the SOS Administrator[37] and "for the opportunity costs associated with its investment dollars needed to provide SOS."[38] The Commission previously determined that the margin is Pepco's return on equity and is not

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[35] District of Columbia Department of Energy & Environment and District of Columbia Office of the Mayor, *Clean Energy DC, The District of Columbia Climate and Energy Action Plan*, at v, xi (August 2018), available at: https://doee.dc.gov/sites/default/files/dc/sites/ddoe/page_content/attachments/Clean%20Energy%20DC%20-%20Full%20Report_0.pdf; D.C. Code § 34-1432(c)(22) (2019 Supp.).

[36] Order No. 19897, ¶¶ 32, 33.

[37] *See Formal Case No. 1017*, Order No. 13268, ¶¶ 62-63, rel. August 19, 2004.

[38] *Formal Case No. 1017*, Order No. 13407, ¶ 37, rel. October 20, 2004 ("Order No. 13407").

based on actual costs incurred by Pepco.[39] Based on the assumption that Pepco, as the SOS Administrator, would be the signatory on the PPA, the Commission requested that the SOS Working Group discuss whether Pepco should receive a margin for administering the PPA.

20. DOEE argues that "Pepco should be compensated or rewarded for successfully procuring a cost-competitive PPA for renewable energy."[40] Since administering the PPA constitutes a new role for Pepco, DOEE believes that Pepco should be rewarded "for a successful outcome as a Performance Incentive Mechanism, consistent with DOEE's filings in Formal Case 1130."[41] OPC does not believe that Pepco should receive any margin or return for administering the PPA.[42] Sierra Club contends that it is appropriate to compensate Pepco for the costs Pepco incurs for administering a long-term renewable energy PPA.[43]

DECISION

21. In Order No. 20232, the Commission noted that, at a minimum, Pepco should be compensated for the incremental cost it would incur in administering the PPA.[44] The issue is whether, how, and at what level Pepco should receive compensation beyond the costs it incurs in administering the PPA. Pepco currently earns a margin for administering the SOS process in addition to recovering its incremental costs. By Order No. 18829, the Commission allowed Pepco to receive compensation going forward equal to the average margin for the last three years, which was set at $6,101,625.00, starting with the June 1, 2018, to May 31, 2019, SOS service year.[45]

22. As previously indicated, under the 95/5 Model, Pepco, as the SOS Administrator, will among other things have to procure the remaining components for that five (5) percent – capacity, losses, congestion, load shaping, credit and risk, and ancillary services – and provisions would have to be made to accommodate the intermittent nature of the renewable energy provided by the PPA. Pepco will be taking on new and different responsibilities as compared to its current role as SOS Administrator in procuring the full requirements SOS product and should be compensated for the risks and opportunity costs associated with these new responsibilities.

23. The Commission has previously determined that Pepco is entitled to receive a margin for administering SOS that is based on the average of the margin for the last three

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[39] Order No. 13407, ¶ 30.

[40] DOEE's Comments at 5.

[41] DOEE's Comments at 5.

[42] OPC's Comments at 2.

[43] Sierra Club's Comments at 1.

[44] Order No. 20232, ¶ 12.

[45] *Formal Case No. 1017*, Order No. 18829, ¶ 143, rel. July 7, 2017 ("Order No. 18829").

years. Therefore, using the approach adopted in Order No. 18829, Pepco's margin for administering SOS, including the PPA, shall be based on receiving the average margin calculated based on a three-year rolling average. Over the last three years, Pepco's collections for the margin (including taxes) have been roughly 2.5 percent of SOS generation revenues.[46] As SOS Administrator for the PPA, Pepco would, in addition, recover its incremental costs in administrating the PPA.

3. Treatment of RECs Generated by the PPA

24. DOEE believes that "the RECs generated by the PPA should be retired, rather than being sold into the PJM market."[47] In addition, DOEE notes that "[o]ne of the main purposes of procuring renewable energy through a long-term PPA for SOS is to reduce GHG [greenhouse gas emissions] attributable to the District's SOS supply."[48] To achieve this purpose, DOEE argues, "the renewable energy attributes associated with the PPAs" must be retired.[49] Selling these RECs into the open market would mean, according to DOEE, "that the energy supply under the PPA would be no cleaner, in terms of GHG emissions, than the average emissions rate in PJM."[50]

25. OPC believes that further investigation is needed to determine how the RECs should be used. With respect to the 95/5 Model, the Sierra Club believes that the simplest option is to retire the RECs under either the 95/5 or Modified 95/5 Model.[51] The Sierra Club also notes that the purpose of the PPA is to facilitate the construction of new additional generation capacity for renewable electricity in the PJM region.[52] Pepco states that it "does not take any formal position with regards to the treatment of the RECs associated with the PPA."[53]

DECISION

26. In Order No. 19897, the Commission, *inter alia*, established this pilot program to procure renewable energy through a long-term PPA with a target quantity of five (5) percent of SOS load.[54] In that Order, the Commission noted that this introduction

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46 *See Formal Case No. 1017*, Order No. 19838, rel. February 27, 2019 (approving Pepco SOS retail rates for the June 1, 2019, to May 31, 2020 SOS service year). S*ee also* Pepco's Retail Rates, Attachment D, at 1-A.

47 DOEE's Comments at 5.

48 DOEE's Comments at 5.

49 DOEE's Comments at 5.

50 DOEE's Comments at 5.

51 The Sierra Club's Comments at 1.

52 The Sierra Club's Comments at 2.

53 Pepco Reply Comments at 5.

54 Order No. 19897, ¶ 1.

of PPAs into the SOS procurement portfolio would preserve "the environmental quality, including effects on global climate change and the District's public climate commitments."[55] The Commission also observed that, while the Commission was starting small with five (5) percent of SOS load, we are taking "direct action to reduce GHG emissions by promoting the construction of new renewable energy generation within PJM."[56]

27. A REC is a market-based instrument that represents the property rights to the environmental, social and other non-power attributes of renewable electricity generation. RECs are issued when one megawatt-hour (MWh) of electricity is generated and delivered to the electricity grid from a renewable energy resource.[57] Both DOEE and the Sierra Club agree that, if the RECs associated with the PPAs were sold separately from the electricity generated, that electricity would no longer be clean, renewable energy. They both suggest that the best course of action is to simply retire the RECs and not separate them from the electricity generated under the PPA.

28. The Commission agrees with DOEE and Sierra Club that selling the RECs separately from the electricity results in the energy no longer being considered as "clean." By using the RECs generated under the PPA to meet a portion of the RPS obligations of all SOS suppliers, the RECs would be retired and energy generated under the PPA would still be considered clean, renewable energy. Accordingly, all RECs from the PPA will be retired to meet the annual RPS obligations of all SOS suppliers, including Pepco. The details regarding how these RECs are to be distributed to suppliers and retired will be determined in a future Order or rulemaking.

B. Imputed Debt and Related Matters

29. In Order No. 20232, the Commission recognized that imputed debt is a concern that may affect a utility's financial ratios and credit rating, while noting that Pepco's statements alone do not quantify the specific impact of long-term PPAs on the Company's balance sheet. We concluded that, absent this showing, the Commission is unable to assess the degree of risk that long-term PPAs would have on Pepco's balance sheet. Accordingly, the Commission directed Pepco to file an analysis indicating the approximate level (percentage of SOS load) at which long-term PPAs represent a material credit and capital structure issue for Pepco and to provide supporting calculations. In addition, Pepco was directed to provide at least one empirical example where S&P or another rating agency has imputed debt from such long-term PPAs onto a utility's balance sheet.[58]

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[55] Order No. 19897, ¶ 22.

[56] Order No. 19897, ¶ 33.

[57] United States Environmental Protection Agency, "Renewable Energy Certificates (RECs)," available at: https://www.epa.gov/greenpower/renewable-energy-certificates-recs

[58] Order No. 20232, ¶ 22.

1. Pepco's Response to Commission Order No. 20232

30. On October 30, 2019, Pepco filed its response to Commission Order No. 20232. Pepco states that "[i]n direct response to the Commission's directive regarding imputed debt, there is no calculation or analysis of which the Company is aware that can conclusively determine the exact inflection point at which LT [long-term] PPAs will cause a credit issue and impair the Company's capital structure."[59] Pepco believes that the layering effect of long-term PPAs will begin to deteriorate the Company's financial condition. Pepco contends that it is very protective of its balance sheet – a position that helps lower borrowing costs over time which also minimizes costs to Pepco customers.[60]

31. As an example of how imputed debt can be viewed by credit rating agencies, Pepco cites to the case of Hawaiian Electric Company ("HECO") which experienced the effect of imputed debt calculated by the S&P rating agency specifically related to power purchase agreements. Pepco notes that HECO serves 95 percent of Hawaii's residents and that the State of Hawaii has a goal to achieve 100 percent renewable energy by 2045. According to Pepco, HECO conducts RFPs for generation and uses long-term PPAs to contract with developers.[61] Pepco contends that, in February 2018, Bates White completed a pre-bid study of HECO's RFP to purchase new, dispatchable and renewable energy resources, and the study revealed that S&P calculates $428.3 million of imputed debt for HECO's PPAs. The study also references the testimony of HECO's CFO in a 2016 rate case stating that the Company's equity position must be increased to account for imputed debt.[62] On this basis, Pepco concludes that HECO's experience demonstrates that PPAs can have a negative effect on a utility's balance sheet that must be accounted for. Pepco also cites the experience of the Public Service Company of Colorado, as another cautionary tale, where imputed debt from long-term PPAs can affect a utility's credit metrics. This case, in Pepco's view, demonstrates that at some level an increase in leverage can have real cost impacts on utility ratepayers via higher costs to borrow.[63]

32. Pepco notes that the Company had proposed at the May 20, 2019, SOS Working Group meeting that the Company not act as a direct counterparty to the PPA.[64] Pepco proposes instead to act as an agent, collecting funds from customers in advance of paying the renewable developer, much like Pepco does for various taxes and surcharges it collects for the District of Columbia.[65] In its filings and comments regarding the PPA,

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[59] Pepco's Response to Order No. 20232 at 2.

[60] Pepco's Response to Order No. 20232 at 2.

[61] Pepco's Response to Order No. 20232 at 2.

[62] Pepco's Response to Order No. 20232 at 2.

[63] Pepco's Response to Order No. 20232 at 2-3.

[64] Pepco's Response at 4 (citation omitted).

[65] Pepco's Response at 4.

Pepco consistently resists taking on the role of counterparty to the PPA.[66] Also, Pepco states that at the May 20, 2019, Working Group meeting, it suggested that the Commission or some District agency, like DOEE act as a counterparty to the PPA.[67]

33. Pepco contends that "there are viable alternatives to traditional PPAs that have been successfully implemented in other states that allow developers to finance renewable projects without negative credit implications for the utility."[68] Pepco asserts, however, that, if the Commission requires Pepco "to enter into a PPA, there are minimum requirements that the Commission should require to protect the utility and its customers."[69] Pepco recommends that the PPA be structured such that the Company has explicit assurance that it will recover all costs associated with the PPA, and the PPA should include provisions to protect the Company from any potential default by the renewable developer(s). Pepco claims that it knows from experience that the optimal method of recovery should be provided by statute as opposed to a method contained in a Commission regulation or directive. However, according to Pepco, given that a statutory change is not imminent, changes to the SOS regulations, while not as certain and explicit as legislative requirements, would likely be viewed by the credit rating agencies as having greater certainty than a Commission directive alone. Pepco recommends that the Commission implement an explicit cost recovery *mechanism* (as opposed to the cost recovery *model* discussed earlier in this Order) in regulations, and that such a "cost recovery regulation should allow the Company to act as payment agent where funds are collected from customers via surcharge to cover all costs, thereby minimizing the risk associated with the use of any utility funds in the PPA process."[70]

2. Comments

34. DOEE indicates that they would not be in a position to serve as a counterpart.[71] In addition, DOEE argues that Pepco's conclusion that signing the PPA will impact its imputed debt is far from certain or supported, and presupposes, without supporting evidence, that rating agencies will treat PPA obligations as debt.[72] DOEE asserts that rating agencies have, instead, "treated contracts such as PPAs as either operating expenses or debt depending on the circumstances."[73] DOEE further argues that,

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66 *See generally* Pepco's Response to Order No. 20232 at 3-5; Pepco's Response at 2-3 and 4-5; Pepco's Response to Order No. 20232 at 2-3; Pepco's Comments at 2; Pepco's Reply Comments at 7.

67 Pepco's Response at 4-5.

68 Pepco's Response to Paragraph 37 at 4.

69 Pepco's Response to Paragraph 37 at 4.

70 Pepco's Response to Paragraph 37 at 4.

71 DOEE's Comments at 6.

72 DOEE's Comments at 7.

73 DOEE's Comments at 7, *citing* "Appendix H: Treatment of Power Purchase Agreements," at 58, Moody's Investors Service, "Regulated Electric and Gas Utilities," as filed by Xcel Energy, available at:

even if PPA obligations were to be treated as debt, Pepco has not clearly demonstrated that it would have such material impact as to completely eliminate the viability of Pepco as a counterparty to the PPA. DOEE acknowledges Pepco's concerns while also noting that in *Formal Case No. 1119*, then-Exelon Corporation's Chief Sustainability Officer stated on cross-examination, when asked about Exelon's commitment to support the District Government's pursuit of long-term PPAs, that the Company supports those efforts and that Exelon has experience with such efforts in Com-Ed and PECO.[74]

35. The Sierra Club takes issue with Pepco's contention that it would need to be protected from default of the renewable developer.[75] The Sierra Club asserts that the default would not imply a financial risk for Pepco, particularly under the Massachusetts Model, and "if the renewable developer defaults, it would not sell any electricity output and Pepco would merely stop making any payments to the developer."[76] In addition, the Sierra Club believes that, under financing models other than the Massachusetts Model, "a default would have minimal implications for SOS procurement that may then have to be increased in volume and hence small amounts of price risk may be incurred."[77]

36. In its reply, Pepco states that, it fully supports the District's clean energy goals. However, Pepco argues that the adoption of a legislative approach along with the funding mechanism – with Pepco acting as a payment agent – provides the appropriate structure to bring these goals to fruition.[78] Pepco asserts that this structure has already been successfully implemented to promote renewable generation in Pepco Holding, Inc.'s ("PHI") Delaware and New Jersey jurisdictions. According to Pepco, given the surge in renewable generation in all PHI jurisdictions, the Company must protect its balance sheet from the impact of future PPAs.[79]

DECISION

37. Pepco cites the HECO experience where PPAs caused HECO's CFO to state during a 2016 rate case that HECO would have to increase its equity position "to account for imputed debt."[80] Pepco notes that HECO which is a vertically integrated electricity

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https://www.xcelenergy.com/staticfiles/xe-responsive/Company/Rates%20&%20Regulations/Rate%20Cases/Attachment-MPS-4.pdf.

74 DOEE's Comments at 6 (citation omitted).

75 The Sierra Club's Comments at 3.

76 The Sierra Club's Comments at 3.

77 The Sierra Club's Comments at 3.

78 Pepco's Reply Comments at 7.

79 Pepco's Reply Comments at 7.

80 Pepco's Response to Commission Order No. 20232 at 3.

utility[81] was serving 27 percent of its load through long-term renewable energy PPAs in 2018. By contrast, the five (5) percent of SOS PPA would represent "roughly 1.4 percent of the District's total annual retail energy load."[82] Obviously, the HECO experience is not comparable to a pilot program for a long-term renewable energy PPA which represents 1.4 percent of the District load. With respect to the Public Service Company of Colorado's experience, Pepco does not indicate what percentage of that company's load was served by renewable energy PPAs, so it is unclear how the Colorado experience is relevant.

38. Pepco indicates that there is no calculation or analysis of which the Company is aware that can conclusively determine the exact inflection point at which long-term PPAs will cause a credit issue and impair the Company's capital structure.[83] Moreover, Pepco claims that it is the layering effect of long-term PPAs in multiple jurisdictions that could have an impact on its balance sheet and financial condition.

39. Pepco is the SOS Administrator and is required to procure electricity to serve 100 percent of the SOS load. By adding a long-term renewable PPA into the SOS procurement portfolio, a quantity of five (5) percent of the SOS load would be served through the PPA and the remaining 95 percent of SOS load would continue to be served through a full requirements product. Inasmuch as Pepco is the SOS Administrator, it has been the counterparty to each contract awarded for the provision of SOS. Accordingly, Pepco is directed, as the SOS Administrator, to act as the signatory or counterparty to the PPA.

40. The Commission does, however, take seriously the potential impact of imputed debt and the complications that could arise if more PPAs are added to Pepco's balance sheet. The Commission understands that a strong balance sheet positions the Company to borrow money at lower rates which also minimizes costs to Pepco customers. To ensure that the Commission is well informed about the impact, if any, that the PPA could have on Pepco's credit metrics, the Commission directs Pepco to file an update within 15 days in the event that it receives information from S&P or any other credit rating agency regarding the impact of the PPA on Pepco's financial condition. In addition, the Commission notes that the prospective PPA represents a 15-year to 20-year commitment. As such, we view the PPA as a non-bypassable component for billing purposes.

41. Finally, Pepco recommends adopting the cost recovery mechanism by statute or regulations (preferably statute) because such action would likely be viewed by credit rating agencies as having greater certainty than a Commission directive alone. By Pepco's own admission, "a statutory change is not imminent..."[84] To minimize the impact

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[81] United States Environmental Protection Agency, "Energy Efficiency and Electric Infrastructure in the State of Hawaii," available at: https://www.energystar.gov/ia/partners/downloads/mou/state_resources/State_Profiles_Hawaii_508.pdf.

[82] Order No. 19897, ¶ 32.

[83] Pepco's Response to Commission Order No. 20232 at 2.

[84] Pepco's Response to Paragraph 37 at 4.

of the PPA on Pepco's balance sheet, the Commission will revise its SOS rules to include the cost recovery mechanism.

C. SOS Rules and Draft RFP

42. As a general matter, the Commission's SOS rules are designed to procure 100 percent of the electricity as a full-requirements product to serve the SOS load. Now that the Commission has decided to procure five (5) percent of the SOS load via a long-term renewable energy PPA, the Commission's SOS rules must be revised accordingly. More specifically and as noted above, the Commission's SOS rules also need to be modified to include the cost recovery mechanism. In addition, the rules need to be revised to accommodate the procurement of the additional energy required to make up for the intermittent and non-load following nature of renewable energy procured under the PPA (if needed) and for the additional components described above that must be procured separately from the PPA itself. A true-up mechanism to account for all the costs associated with PPA must also be added to the SOS rules. Accordingly, the Commission will issue a Notice of Proposed Rulemaking in the *D.C. Register* amending the Commission's Standard Offer Service rules.

43. As previously indicated, on July 31, 2019, Pepco, on behalf of the SOS Working Group, filed a draft RFP along with its comments addressing a number of issues affecting the PPA, and redlined edits to and comments on the draft RFP from Commission Staff, CRI, AOBA, the Sierra Club, and WGL Energy.[85] The draft RFP refers to a "final agreement" that the winning bidder will sign with the counterparty which is the PPA itself. The Commission in Order No. 20232 issued on October 10, 2019, solicited comments on these documents.[86] Only DOEE responded noting that Pepco did not submit the draft final agreement, and as such, parties to the proceeding should have the opportunity to review and comment on that document before it is issued as part of the RFP.[87]

44. Based on the 95/5 Model adopted in this Order and the comments, including the redlined edits, received on the draft RFP, the Commission directs Pepco to file a revised RFP and a draft final agreement within 30 days of the date of this Order. The Commission anticipates that the RFP will be issued by Pepco in September 2020.

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[85] Pepco's Response at 2.

[86] Order No. 20232, ¶¶ 1, 18, 25.

[87] DOEE's Comments at 11.

THEREFORE, IT IS ORDERED THAT:

45. The 95/5 Model of cost recovery for the pilot program to procure renewable energy through a long-term power purchase agreement for a target quantity of five (5) percent of the Standard Offer Service load is hereby **ADOPTED**;

46. The margin that the Standard Offer Service Administrator will receive as the counterparty to the long-term renewable energy power purchase agreement is hereby **ESTABLISHED**, consistent with paragraph 23 of this Order;

47. The Tier One Renewable Energy Credits generated by the long-term renewable energy power purchase agreement will be **RETIRED** to meet a portion of the annual Renewable Energy Portfolio Standard obligations of all Standard Offer Service electricity suppliers;

48. The Potomac Electric Power Company is hereby **DIRECTED**, as the Standard Offer Service Administrator, to act as the counterparty to the long-term renewable energy power purchase agreement, consistent with this Order;

49. The Potomac Electric Power Company is hereby **DIRECTED** to file an update in the event the Company receives any information from Standard & Poor's or any other credit rating agency regarding the impact of the long-term renewable energy power purchase agreement on Pepco's financial condition within 15 days of receipt of that information, consistent with paragraph 40 of this Order; and

50. The Potomac Electric Power Company is **DIRECTED** to file a revised request for proposals and a draft final agreement, consistent with paragraphs 43 and 44 of this Order, within 30 days of the date of this Order.

A TRUE COPY: **BY DIRECTION OF THE COMMISSION:**

CHIEF CLERK **BRINDA WESTBROOK-SEDGWICK**
COMMISSION SECRETARY