

November 5, 2009

**BY ELECTRONIC MAIL**

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Michael Pleasant  
Department of Energy Resources  
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Dear Mr. Pleasant:

Please accept this letter as the comments of Constellation Energy Commodities Group, Inc. ("CCG") and Constellation NewEnergy, Inc. ("CNE", collectively "Constellation") and Direct Energy Services, LLC and Direct Energy Business, LLC (collectively "Direct Energy") related to the issues discussed at the at the Department of Energy Resources' ("DOER") October 23, 2009 public hearing regarding the Price Support Mechanism to the DOER's straw proposal for a solar carve-out within its Renewable Portfolio Standard ("RPS") Class I regulations ("RPS Solar Carve-Out"). Constellation and Direct Energy appreciate the opportunity to comment on these important issues.

CCG is a power marketer authorized by the Federal Energy Regulatory Commission to sell energy, capacity and certain ancillary services at market-based rates. CCG serves the full requirements power needs of distribution utilities, co-ops and municipalities that competitively source their load requirements, including in the Commonwealth of Massachusetts. CNE is a licensed retail electric provider in the Commonwealth of Massachusetts and a leading supplier of retail electric service throughout New England. Direct Energy is a licensed retail electric supplier in the Commonwealth of Massachusetts and provides retail electric and natural gas products and services to residential and business customers throughout the United States and Canada.

**Background**

On August 26, 2009 the Department held a public stakeholder meeting to solicit input regarding proposed modifications to the renewable portfolio standards to provide a price support mechanism for the expanded development of solar photovoltaic generation within Massachusetts. More specifically, the Massachusetts Green Communities Act grants the DOER certain authority to require that a portion of the power supplied to meet RPS obligations be met through energy generated from specific technologies or from specific fuel sources. Section 32, Section 11F(g) of the Act provides:

(g) In satisfying its annual obligations under subsection (a), each retail supplier shall provide a portion of the required minimum percentage of kilowatt-hours

sales from new on-site renewable energy generating sources located in the commonwealth and having a power production capacity of not more than 2 megawatts which began commercial operation after December 31, 2007, including, but not limited to, behind the meter generation and other similar categories of generation determined by the department. The portion of the required minimum percentage required to be supplied by such on-site renewable energy generating sources shall be established by the department; provided, however, that the department may specify that a certain percentage of these requirements shall be met through energy generated from a specific technology or fuel type.

Pursuant to this authority the DOER is proposing a Solar RPS Carve Out. Under an initial straw proposal the Department released in connection with the August 26 meeting, retail electric suppliers are required to meet a certain percentage of the RPS Class I mandate through solar photovoltaic generation credits (SRECs), tracked through the regional GIS system. The initial straw proposal also relied heavily on the use of long-term utility contracts as a mechanism to provide revenue certainty to solar PV developers.

On October 22, 2009, the DOER released for discussion a Program Design and Analysis Document with an alternative SREC price support mechanism and on October 23 held a second public stakeholder meeting to solicit comments on the modified proposal. The modified proposal relies upon an RPS carve out, but replaces reliance on utility contracts with a fixed-price put mechanism to give developers greater price certainty.

Constellation participated in both stakeholder meetings and has met informally with DOER to provide feedback on the straw proposals. Our comments below are directed specifically to the modified proposal discussed at the October stakeholder session.

### **Need for Certainty of Obligation**

The Auction mechanism is explained in the program Design and Analysis Document as follows:

S-RECs opted to the Auction Account are “re-minted” by the NE-GIS into Extended Life S-RECs with a Shelf Life to be eligible for compliance over the next two compliance periods. DOER will hold an auction soon after the compliance year to sell these Extended Life S-RECs. The auction will be for a fixed price of \$300 per S-REC (MWh). Utility and competitive retail electricity suppliers will bid in the auction for the volume they are willing to buy for this price. If insufficient volume is bid, the auction will be repeated with one additional year added to the Shelf Life of the Extended Life S-RECs. The auction is repeated as necessary until the volume bid is sufficient to clear the available Extended Life S-REC volume.

The SREC Price Support mechanism is designed to create a price floor for SRECs without the need for direct governmental subsidies. It does this by having DOER

administer a fixed price auction in which the compliance Shelf Life of SRECs sold at the predetermined auction price is expanded until the auction clears. Critical to the success of this market-based mechanism is the active participation of willing sellers and willing buyers, both with a mutual desire to contract forward.

As a general matter, parties may purchase renewable energy certificates for a variety of reasons. Load Serving Entities (“LSEs”) may purchase RECs to provide renewable energy products to their customers or to meet RPS requirements; customers may purchase RECs directly and retire them to reduce their own environmental footprint; and traders may purchase RECs on speculation with the intent to re-sell them. By far, however, the greatest driver of demand for all RECs is the RPS. In the case of SRECs, the proposed carve out will enhance the market value of a SREC for compliance purposes and enable SRECs to be sold at prices over a term that are more capable of supporting project financing.

Critical to the success of this mechanism is the ability of the DOER to enhance the value of SRECs by extending their Shelf Life. In theory, LSEs will be willing to purchase SRECs today as a hedge against compliance obligations in the future. To understand whether this will be the case in practice, however, requires a closer examination of hedging and portfolio management practices used in meeting load serving obligations.

### **Hedging Practices**

In Massachusetts, nearly all load is served, directly or indirectly, by competitive suppliers, who either provide wholesale service to distribution companies and municipalities or who provide retail service directly to end-use customers. In either case, the load serving supplier must provide fixed-price electricity on demand to its customer for the term of the contractual commitment. To manage price risk, suppliers will contract forward for a portfolio of physical and financial products, adjusting the portfolio over time to match changes in demand or to take advantage of changes in market conditions. To meet RPS obligations the supplier will contract for RECs. Like energy and capacity, the REC quantity required to meet load will vary depending on energy consumption, and adjustments to REC holdings will need to be made within the portfolio. Unlike energy and capacity, however, changes to RPS requirements will also have an impact on REC demand as well.

In deciding what REC purchases to make for the portfolio, an LSE faces several risks. If the price of RECs goes up and no hedges have been purchased, then the portfolio manager is stuck having to cover compliance obligations in a high price market. It would therefore seem prudent to cover at today’s REC prices with a forward purchase and to bundle the cost of those RECs into the sales price to the customer. Against this, however there is a risk associated with buying forward that tends to discourage forward hedging. That is the risk associated with changes to REC requirements. RPS requirements can potentially change in two ways: changes to product and changes to quantity. If the definition of qualified renewable resources is changed, the LSE’s portfolio manager

could be left with RECs that do not qualify to meet the compliance obligation. The second possibility is changes to the quantity. If the RPS percentage is increased unexpectedly, the portfolio manager will have to procure more RECs at a time when there is increased demand in the marketplace and presumably prices are higher. Conversely, if the percentage required is reduced, then the LSE may find itself with excess RECs in a market where demand is lower and so presumably are prices.

### **Stability of Obligation**

Historically, the Commonwealth has implemented the RPS obligations in a way that minimizes risk to the LSE that hedges its RPS obligations in several ways. First, when new RPS product obligations are imposed, such as the creation of a new RPS Class, the Commonwealth has grandfathered existing retail energy contracts for the remainder of their term. By grandfathering existing retail sales, the Commonwealth has given LSEs confidence to contract forward with retail customers and with renewable generators. This is an important precedent and has been the policy of the General Assembly to date. Second, the General Assembly has specified in the statute step increases in the RPS percentages for Class I and II to allow suppliers to know with certainty today what the RPS quantity requirements will be for many years into the future.

Under the Green Communities Act, the DOER may have some discretion to establish product and quantity requirements for an SREC carve out. By following the General Assembly's lead in grandfathering existing contracts and setting fixing quantity requirements for a period of years, however, the Department can send a message to LSEs that it is safe to continue to enter into forward contract arrangements within Massachusetts. By contrast, imposing new product requirements on existing contracts and subjecting LSEs to potential annual changes in quantity requirements will materially increase forward contracting risk and discourage forward load and supply commitments. Portfolio managers will then seek to manage their regulatory risk in one of two ways. First, by shortening the length of their retail load serving contracts, perhaps to 12 months or less, LSEs and their customers can re-price and re-negotiate at the time of annual renewal, minimizing the risks associated with changes in RPS requirements. This, however, will severely restrict the incentive an LSE otherwise might have had to purchase SRECs today for use as a hedge against future compliance obligations. Alternatively, LSEs can offer longer term contracts for electricity with a pass-through for RPS compliance costs. This shifts the regulatory risk from the LSE to the customer but also undercuts the LSEs incentive for REC hedging for that customer. In short, uncertainty of RPS obligations significantly diminishes the value of extending the SREC Shelf Life and creates a greater risk that insufficient demand will participate in the auction for it to clear. Uncertainty as to future SREC requirements may also adversely affect the bilateral market for other types of RECs which do not enjoy the support of the fixed-price auction.

## **Trading on Speculation**

Apart from hedging activity for compliance purposes, it is also possible to imagine demand for SRECs in the proposed auction by trading firms who are willing to purchase extended-life SRECs on speculation and hold them for re-sale. Such forward trading activity will require trading firms to form a forward view as to SREC prices.

Unfortunately, the same risks associated with changes in product and changes in quantity that would discourage LSEs forward hedging also create future price uncertainty for trading firms. That is, changes to RPS requirements can dramatically alter the forward price curve for SRECs. Traders will therefore be reluctant to buy forward because it will be difficult to form a view on whether prices will be driven up or down based on market fundamentals. In addition, prices can also be driven downward by changes to the ACP, which may be adjusted downward annually under the DOER proposal, creating further price uncertainty. Finally, taking a forward position commits capital and, in many cases, exposes the trading firm to mark-to-market accounting risks. Although these risks are inherent in trading activity, deploying capital toward more liquid and stable markets may be more attractive than speculating on SRECs, even where Shelf Lives are extended out for a number of years.

## Conclusion

DOER has put forward a creative, market-based solution to giving solar PV developers price certainty for a term of years without relying on subsidies or mandating contracts with regulated distribution companies. Critical to the success of the proposal, however, is the encouragement of forward contracting by competitive suppliers. For suppliers to place a value today on SRECs that can be used in the future will require DOER to give greater certainty of RPS obligations than the present proposal offers. Grandfathering existing retail contracts and fixing the percentage obligation for a term of years are simple solutions that the DOER can adopt consistent with the policies the General Assembly has endorsed over time. Fixing the ACP as well may also encourage more forward trading interest in SRECs.

Constellation thanks the Department of Energy Resources for the opportunity to submit these comments. Please do not hesitate to contact the undersigned below if you have any questions or comments.

Respectfully submitted,

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