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Director

May 30, 2013

Via Hand Delivery and Electronic Mail
Honorable Kristi Izzo, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, New Jersey 08625-0350

Re: Combined Heat and Power/Fuel Cell Working Group May 2, 2012 Request for Comments on Staff Draft Straw Proposal Combined Heat and Power (CHP) Long Term Financing Incentive Mechanism—a "Smart" Portfolio Standard Revised Draft Dated April 15, 2013

Dear Secretary Izzo:

Enclosed please find an original and ten copies of the Comments submitted on behalf of the New Jersey Division of Rate Counsel ("Rate Counsel") in connection with the above-captioned matter. Copies of the comments are being provided to all parties on the e-service list by electronic mail and hard copies will be provided upon request to our office.

We are enclosing one additional copy of the comments. Please stamp and date the extra copy as "filed" and return it in our self-addressed stamped envelope.

Thank you for your consideration and assistance.

Respectfully submitted,

STEFANIE A. BRAND
Director, Division of Rate Counsel

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Staff Draft Straw Proposal
Combined Heat and Power (CHP) Long Term Financing
Incentive Mechanism—a "Smart" Portfolio Standard
Revised Draft Dated April 15, 2013

Comments of the New Jersey Division of Rate Counsel

May 30, 2013

The Division of Rate Counsel ("Rate Counsel") would like to thank the Board of Public Utilities ("BPU") or ("Board") for the opportunity to present comments on the April 15, 2013 Revised Draft Straw Proposal for a "Combined Heat and Power (CHP) Long Term Financing Incentive Mechanism—a 'smart' Portfolio Standard." The Straw Proposal was circulated by the Office of Clean Energy ("OCE") Staff and was discussed at the April 30, 2013 meeting of the OCE's CHP Working Group. By e-mail notice dated May 2, 2013, the OCE requested comments on the Straw Proposal by May 30, 2013.

Introduction

Rate Counsel has serious concerns about the Straw Proposal. The Straw Proposal is completely lacking in any empirical support for the proposed transition from the existing system of rebates and grants for CHP. There is no analysis to demonstrate that the proposed "CHP portfolio standard" will be more cost effective than the existing program, much less that it represents the most cost-effective option. The Straw Proposal also contains no analysis of how Staff's proposal will advance its stated goals of encouraging development of CHP facilities in general or for "public critical facilities" that can play a role in storm response. There has been no analysis of the reasons for the poor responses to the existing program, and no effort to identify program features that would remedy identified deficiencies in the current program.

Furthermore, the portfolio standard mechanism envisioned by Staff has serious flaws. The Straw Proposal is confusingly written and lacking in crucial details, but even the limited details that are provided raise numerous practical issues. The mechanism that appears to be envisioned by OCE would at best be complicated and expensive to administer, and it may be completely unworkable. The Straw Proposal also would lack transparency with regard to costs. Unlike OCE's current CHP programs, which are conducted under a publicly available budget, the proposed mechanism would have its costs embedded within the rate structures of four separate utilities. The costs of the program would be difficult to ascertain for the general public, and, perhaps, also for experts.

Assuming that the development of CHP for critical facilities is a reasonable goal, the proposed portfolio standard will not achieve it. If it is workable at all, it will be complicated and costly. Rather than attempting to implement a novel and untested mechanism, Staff should first evaluate its existing programs, and conduct a careful analysis to identify the least cost alternative for reaching that goal, whether modifications to existing programs or a new proposal.

Proposed CHP Portfolio Standard

According to the Straw Proposal, its goal is "[t]o develop a long term secure and stable funding/financing source to implement the 2011 Energy Master Plan ("2011 EMP") target that includes both storm response CHP and dual economic and environmental benefit CHP." Although the Straw Proposal includes some discussion of the overall 2011 EMP goals, a primary focus of both the proposal and the April 30, 2013 CHP Working Group meeting was a "CHP portfolio standard" to be implemented in the near term to promote the development of CHP at "critical public facilities,' which Staff defines as publicly owned facilities that "could operate

24/7 and either temporarily or long term house, feed and shelter evacuated victims from an emergency such as super storm Sandy." Straw Proposal, p. 3-4.

OCE is proposing a mechanism that is type of portfolio standard. The proposed mechanism would require each of New Jersey's four natural gas utilities to procure CHP generation, to be located at critical public facilities, in annual amounts based on percentages of the CHP goals stated in the 2011 EMP. As clarified at the April 30, 2013 meeting, the utilities would not directly procure given amounts of CHP capacity, but rather units of energy savings resulting from the use of the CHP facility's thermal output. See April 30, 2013 meeting presentation, Slide # 8. OCE is proposing what it characterizes as a "smart" portfolio standard, i.e., one that can be increased or decreased by the Board based on "market conditions." Straw Proposal, p. 2.

Rate Counsel Concerns

Lack of empirical foundation for proposal

Rate Counsel is also concerned that OCE's proposal is premature. Staff states that the current rebate/grant structure would transition to the new long term portfolio standard as it is developed. Straw Proposal, p. 4. The Board has previously recognized since January 2007 the need for renewable energy, and particularly solar energy development, to reduce reliance on rebates and other direct payments in favor of market-based mechanisms.[1] However, the Board only arrived at this conclusion with regard to these markets after a nearly two year investigation which included the formation of a specific working group to develop white papers outlining

[1]Decision and Order Regarding Solar Electric Generation, BPU Docket No.EO06100744, In the Matter of the Renewable Energy Portfolio Standards – Alternative Compliance Payments and Solar Alternative Compliance Payments, pg. 2.

potential new transitional models, and the contracting of a consulting firm to perform independent analyzes of the proposals.[2]

One of the key findings of the many studies prepared through the Board's investigation in its Docket No. EO06100744 was with regard to the projected ratepayer impacts. The Board's consultant found that the previous rebate-heavy régime over-financed solar energy projects by \$2.796 billion,[3] while providing substandard results. The analysis also found that the proposed new financing mechanism was by far the least expensive proposal for ratepayers.[4] This finding confirmed the Board's position that the previous financing system based around rebates was unsustainable in the long-run.

Staff's proposed CHP portfolio standard contains no such empirical foundation, and it is not clear that the findings regarding renewable energy financing structures would hold for CHP. Instead, the proposal is completely opaque with regard to many important policy questions. The proposal claims that it will be rate neutral, by including adjustments to either the overall Utility E3 (energy efficiency) or Clean Energy Program Societal Benefit Charge ("SBC"). Straw Proposal, p. 5. However, Staff is proposing only that the entire Clean Energy Program budget not increase with the introduction of the proposed portfolio standard. Missing still is any analysis of the costs associated with the program and any analysis showing that the proposed mechanism would result in the least cost when compared to the current or alternative financing structures. As elaborated further below, Rate Counsel recommends Staff first conduct all necessary analyses of CHP within the State, including a feasibility analysis, ratepayer impact analyses, and an in-

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[2]Decision and Order Regarding Solar Electric Generation, BPU Docket No.EO06100744, In the Matter of the Renewable Energy Portfolio Standards – Alternative Compliance Payments and Solar Alternative Compliance Payments, pg. 2.

[3] An Analysis of Potential Ratepayer Impact of Alternatives for Transitioning the New Jersey Solar Market from Rebates to Market-Based Incentives, July 31, 2007 Revised Draft, New Jersey Board of Public Utilities, p. 4.

[4] An Analysis of Potential Ratepayer Impact of Alternatives for Transitioning the New Jersey Solar Market from Rebates to Market-Based Incentives, July 31, 2007 Revised Draft, New Jersey Board of Public Utilities, p. 4.

depth review of the causes of the lackluster support received by the previous competitive solicitations for CHP. Only then will Staff and stakeholders possess enough information to make informed decisions regarding changes to CHP financing within New Jersey.

Lack of clearly defined objectives

Rate Counsel also is concerned that, even aside from any consideration of cost-effectiveness, the Straw Proposal does not clearly define its goals, or explain how those goals would be met by the proposed CHP portfolio standard. The Straw Proposal states that one of its objectives is to "[d]evelop a near term CHP storm response program for critical public facilities," and proposes to set RPS requirements based on the CHP goals in the 2011 EMP. The Straw Proposal does not, however, specify what those goals should be or provide any justification for such goals. The Straw Proposal does not mention any analysis of the market potential for CHP, and in particular the market potential for CHP at critical public facilities. If OCE wishes to consider promoting CHP at critical public facilities, it should first assess the market potential for cost-effective CHP at critical public facilities, the barriers to development of such CHP, and possible means for overcoming those barriers.

Before embarking on a novel approach such as the proposed portfolio standard, OCE should conduct a thorough evaluation of the best means of achieving the CHP goals set forth in the 2011 EMP. Such an evaluation should include an analysis of OCE's existing CHP programs. Over the past several years, development of both small and large CHP projects has been sluggish despite the availability of attractive incentives under the existing programs. OCE should first evaluate the reasons why the present incentive structure has not been successful. OCE could then present a proposal that remedies the specific deficiencies found in the current incentive structure. Such a proposal could include, for example, measures to identify thermal loads that could be served by CHP on an economic basis, and changes in the types of incentives being offered such as financing mechanisms in addition to or in lieu of the present rebate structure.

Unworkability of proposed structure

The Straw Proposal is lacking in critical details that would define how the CHP portfolio standard would actually work. As stated in the Straw Proposal itself, the details that remain to be worked out before the proposed portfolio standard could be implemented include further definition of eligible "public critical facilities," the maximum sizes of the CHP facilities, eligible technologies and fuel types, and types and levels of incentives to be provided to the CHP developers. Straw Proposal, p. 4.

In particular, it is not clear how the CHP procurement process would operate. As noted above, Staff appears to be envisioning a process whereby the gas utilities would procure energy savings. OCE has not clearly defined how the energy savings to be procured would be determined, measured, and tracked, and the few details that have been provided raise more questions than they answer.

A particularly puzzling aspect of the Straw Proposal is the proposal to consider only those savings resulting from the use of the thermal output of the CHP facility, and disregard the "additional gas used to generate the electricity." Straw Proposal. p. 3; April 30, 2013 meeting presentation, Slide # 8. Staff apparently intends to focus solely on the efficiency of CHP as a generator of thermal output, disregarding the benefits resulting from use of heat that would otherwise be wasted to generate electricity. A new boiler used for CHP may be more efficient that an old existing boiler, but is unlikely to be substantially more efficient than a standard new boiler that would be a likely alternative to CHP. By ignoring the benefits resulting from the concurrent generation of useful thermal output and electricity, the Straw Proposal assures that the primary benefit of CHP, capturing otherwise unused heat to generate electricity, will not be properly measured, valued or incentivized. The proposed procurement process will not result in the selection of the projects that are the most efficient and cost-effective overall.

Aside from OCE's mistaken focus on the "thermal" side of CHP, the proposal is lacking in any suggested benchmarks or protocols for measuring savings, and also lacking in any suggestions for how such savings should be documented for a proposed project, and verified after a project is placed in service. This is likely in any event to require a complicated and costly administrative structure to measure and track the savings procured, and then delivered by the CHP facilities.

Further, the proposed portfolio standard would create a much less transparent cost structure than OCE's current CHP program. The current program operates under a Board-approved budget that is public. Both budgeted and actual expenditures are easily accessible from the Board Orders and other materials available on the OCE website. Cost information would be much less accessible under the proposed CHP portfolio standard. The ratepayer-funded subsidies inherent in the program would be embedded within the rates of four separate utilities, making it difficult for members of the public, or even experts, to determine the total costs of the program. On a related issue, Rate Counsel also notes its disagreement with the proposition that the development of a "non-lapsable funding source" should be a primary objective of program to encourage CHP. Straw Proposal, p. 1. OCE can assure that ratepayer funds are used effectively through a systematic process of evaluation and planning, and then spending according to those plans. A non-lapsable funding source that comes at the cost of transparency is not beneficial to ratepayers or in the public interest.

Conclusion

For the reasons discussed above, OCE should not proceed further with the propose CHP portfolio standard. This proposal is offered with no supporting analysis, and would be overly complicated, costly, and lacking in transparency. The Straw Proposal, at this time, does not provide a usable framework for encouraging the development of CHP.