



SOUTH CAROLINA SOLAR BUSINESS ALLIANCE, LLC

December 16, 2013

Public Utilities Review Committee
Post Office Box 142
Columbia, South Carolina 29202

Re: Distributed Energy Resources Initial Draft Report

Gentlemen,

The South Carolina Solar Business Alliance, LLC is a trade organization formed to create a positive business environment for renewable solar energy in South Carolina by advocating for legislative and regulatory changes to existing barriers. Our members include businesses that design, install, manufacture and provide professional services related to solar energy generation. We have an acute interest in the EAC report on distributed generation (DG) that will guide and influence future policy as it relates to solar generation in our state.

The Distributed Energy Resources Initial Draft Report is a very comprehensive compilation of issues facing greater penetration of DG, the background for traditional rate setting and the terms and methodology used by the utilities. The report provides valuable insight for laypersons wanting to understand the differing perspectives of utilities and solar energy proponents. The report undoubtedly attempts to reach a consensus of its committee members and, as a result, takes no position or reaches any conclusion on the impact of DG penetration. With that understanding, we respectfully wish to submit our comments in both a strike-and-insert version of the report (redline file attached) and supplemental commentary in the body of this letter. Our redline changes are intended to strike a balance and impartial neutrality to the report and, where needed, greater clarity.

With respect to our supplemental comments we would offer the following comments:

Third-party Ownership of DG Is a Key Tool to Allow Tax-Exempt Entities to Enjoy the Benefits of Onsite DG and to Facilitate DG on Military Installations.

Third-party ownership of DG is ideally suited for tax-exempt entities such as schools, churches, non-profit organizations, and governmental entities. These types of entities typically have little desire or capability to assume the burden of operation and maintenance of a renewable energy system, do not want to assume the risks of operation or mobilize the initial outlay of capital required to install and, most importantly, cannot capture the benefits of federal tax benefits for investments in renewable energy. Without tax liability, these entities are simply unable to take advantage of the tax incentives offered at the federal level. These incentives are not trivial – by combining federal investment tax credits with accelerated depreciation, the capital cost of a solar energy system can be reduced by up to 60 percent.¹ As a matter of basic economics, reducing costs of installing DG through third-party ownership models will spur market growth.

¹ See Solar Energy Industry Association, Guide to Federal Tax Incentives for Solar Energy, Version 1.2, Executive Summary.



In light of these benefits, the third-party ownership model would be significant in allowing military installations in South Carolina to efficiently meet federal renewable energy procurement requirements by leveraging these options. In fact, the federal government has announced that it will seek within the next 7 years, to ensure that 20% of all electricity consumed by the federal government would come from renewable sources. Allowing third-party ownership in South Carolina would assist in this effort, as well as providing additional energy security to facilities that are vital to national security.

Military Third Party Financing Issues

As it relates to third party sales, there are other issues, like national security and supporting the U.S. military that also must be considered. Renewable energy financing in America today generally does not take the form of traditional project or equipment financing because renewable energy equipment qualifies for a number of federal, state or local incentives. As such, it is generally not economically rational to attempt to finance solar or other renewable energy equipment without doing so in a manner that takes maximum advantage of the federal, state or local tax or financial incentives that are available.

However, because one of the most economically valuable incentives for solar and other renewable energy equipment is the federal investment tax credit equal to 30% of the capital cost of the equipment, virtually every solar or renewable energy equipment financing will be required to comply with the very detailed and specific rules of the tax code.

Specifically, Treasury Tax Regulation 1.48-1(j) and (k) PREVENT a taxpayer from receiving ANY federal section 48 30% income tax credit for solar or renewable energy equipment that is leased either to a governmental or tax exempt entity. Note that the section 48 tax credit is generically known as a "general business credit" and thus, is also a "section 38 property" that is referenced below.

Per current federal tax regulations:

(j) Property used by certain tax-exempt organizations. The term "section 38 property" does not include property used by an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by chapter 1 of the Code unless such property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511. If such property is debt-financed property as defined in section 514(b), the basis or cost of such property for purposes of computing qualified investment under section 46(c) shall include only that percentage of the basis or cost which is the same percentage as is used under section 514(a), for the year the property is placed in service, in computing the amount of gross income to be taken into account during such taxable year with respect to such property. The term "property used by an organization" means (1) property owned by the organization (whether or not leased to another person), and (2) property leased to the organization. Thus, for example, a data processing or copying machine which is leased to an organization exempt from tax would be considered as property used by such organization. Property (unless used predominantly in an unrelated trade or business) leased by another person to an organization exempt from tax or leased by such an organization to another person is not section 38 property to either the lessor or the lessee, and in either case the lessor may not

elect under §1.48-4 to treat the lessee of such property as having purchased such property for purposes of the credit allowed by section 38. This paragraph shall not apply to property leased on a casual or short-term basis to an organization exempt from tax.

(k) Property used by governmental units. The term “section 38 property” does not include property used by the United States, any State (including the District of Columbia) or political subdivision thereof, any international organization (as defined in section 7701(a)(18)) other than the International Telecommunications Satellite Consortium or any successor organization, or any agency or instrumentality of the United States, of any State or political subdivision thereof, or of any such international organization. The term “property” used by the United States, etc. means (1) property owned by any such governmental unit (whether or not leased to another person), and (2) property leased to any such governmental unit. Thus, for example, a data processing or copying machine which is leased to any such governmental unit would be considered as property used by such governmental unit. Property leased by another person to any such governmental unit or leased by such governmental unit to another person is not section 38 property to either the lessor or the lessee, and in either case the lessor may not elect under §1.48-4 to treat the lessee of such property as having purchased such property for purposes of the credit allowed by section 38. This paragraph shall not apply to property leased on a casual or short-term basis to any such governmental unit.

We believe the report should at least acknowledge that preventing third party financing effectively blocks U.S. military bases in South Carolina from accomplishing their mission of adding secure renewable energy sources. The utility has a legal obligation to also follow federal policy and national security.

The Report Should Clarify that Third-Party Owners Provide a Distinct Service that Does Not Upend the Rights and Obligations of Electric Utilities.

The report suggests that modifications to current law to allow third-party sales would disrupt the “balance of interests” in the so-called “regulatory compact” by allowing customers to choose onsite DG in lieu of utility service (page 47). We suggest that this premise should be dropped from the report as it is not factually accurate and suggests a cascade of negative consequences that have not materialized in states that do allow third-party sales. Allowing third-party sales or leases would merely clarify that a private activity—the installation of DG on a customer’s property, on the customer’s side of the utility meter, and through a financing instrument of the customer’s choosing—is not the proper concern of public utility regulation.

At the outset, it is necessary that the report recognize that third-party owners (“TPO”) of DG and traditional, monopoly utilities provide fundamentally different “services.” A utility must provide around-the-clock assurance of a safe and reliable supply of electricity, through a combination of distribution, transmission, and generation facilities, each of which have been dedicated to public service. A TPO provides generation to a customer as it becomes available, entirely within the confines of a customer’s private property without using the utility’s publicly dedicated property. A utility provides service and charges rates according to public interest standards embodied in Commission-approved tariffs because captive customers have no other option for “essential” utility service to meet their everyday electricity needs and require regulatory protection. A TPO,

on the other hand, allows qualifying customers to freely enter contractual agreement for provision of “supplemental” generation that is clean, onsite and provided on an “as available” basis, not “as needed”. A utility must serve all who apply. A TPO may select its customers based on proprietary criteria, including site suitability and creditworthiness.

Given these differences in services, the utilities’ right to be the exclusive electric supplier in a defined territory under the regulatory compact is not in conflict with allowing third-party ownership. Utilities in regulated markets that allow third-party ownership continue to enjoy the rights of the regulatory compact: (1) the opportunity to earn a reasonable rate of return; and (2) the right to be the exclusive provider of “utility” services in their service territories.

Because third-party owners of DG do not look or act like utilities (who have dedicated property to **public service**), the primary rationales underpinning territorial exclusivity should not apply. The primary rationales behind granting a utility territorial exclusivity in exchange for the utility assuming the obligation to service are (1) to prevent an incumbent utility from facing ruinous competition and (2) to prevent the wasteful duplication of facilities required to accomplish utility service.

First, even under a generous estimate of third-party market penetration, there is no credible risk of “ruinous” competition to utilities. The size of the third-party market, moreover, typically depends on the availability of state-specific programs, such as net metering or solar rebates, so there is a natural limiting principle to the size of the third-party DG market. Second, third-party owners have no desire to duplicate the extensive utility distribution and transmission infrastructure; they prefer to operate solely on the customer’s side of the meter and do not rely on public rights of way or powers of eminent domain. In terms of generation, the concerns over duplication of facilities must be considered in light of the fact that both federal law and state law invites customers to install generation on their own, private property to encourage diversity of resources and to reduce reliance on fossil fuels. There is no credible basis to claim that encouraging customer installation of additional DG capacity would be wasteful or duplicative.

We request that the discussion of third-party DG be modified to reflect the fact that third-party owners of DG would not offer a service that customers could take “in lieu of” utility service. This fact is critical in establishing that third-party ownership is really about creating opportunities for growth in the **private** market and is not capable of presenting a replacement to the regulated electric service of **public** utilities.

The Report Should Be Modified to Clarify that Both Third-party Sales and Leases Are Simply a Means for Customers to Install DG and Do Not Herald the Coming of Retail Choice or Deregulation.

While we suggest that the final section of the report (from pages 45-49) should be modified to reflect key distinctions between the service provided by an electric utility and third-party owners of DG, we applaud the report for recognizing that a third-party lease does not look like utility service. As the report notes, a third-party lease arrangement would “merely provide the means for the customer to self-generate electricity” without the upfront capital investment. Recognition that third-party ownership is merely the means for a customer to **self-generate** is key to the



understanding of what drives the success of third-party ownership models. Given this recognition for third-party leases, we question why the report concludes that other forms of arranging for self-generation, such as entering a power purchase agreement with a third-party owner of DG, would upset the exclusive service of utilities in their service territories:

In the event that direct sales to retail customers are permitted from *third-party electric power suppliers*, the exclusive relationship between the franchised utility and its customers as currently defined is altered. Policymakers should address if the possible removal of exclusivity in *service provider* would affect the franchised utility's obligation to provide service to the participating customer including removing, in whole or in part, that obligation. [Report at p. 47].

We respectfully disagree that a distinction must be drawn between leases and direct sales in order to respect the rights and obligations of utilities. Instead, we suggest that third-party owners of DG do not provide the types of services that would make them similar to electric utilities or that would warrant exclusion from providing their services within the service territories of electric utilities. Accordingly, the report should be modified to align the discussion of third-party sales with the discussion of third-party leases in the conclusion that allowing those sales does not upset the rights and obligations of electric suppliers.

The only meaningful difference between customer-owned generation system installed through a bank loan and customer-sited generation installed through a third-party power purchase agreement or lease is the customer's choice of financial instrument to facilitate the installation. It is hard to see how allowing any of those arrangements would change the private character of customer-sited generation or herald the coming of retail choice. Each of these options is grounded on the fact: all activity occurs on a customer's private property and on the customer's side of the meter.

Moreover, regardless of the means of installation permitted by state law, federal law guarantees the basic right of customers to install onsite generation and to operate that generation in parallel with the utility's grid (i.e., to serve onsite load). In this regard, a TPO—whether offering a lease or a PPA—merely provides a financially viable means for adoption for customers that might not be able to afford to purchase a system outright. This can easily be clarified by a legislative act stating that third-party owners of DG are not—under the proper circumstances where the service retains its private character—electric public utilities.

Final comments

South Carolina is clearly at the early stages of low penetration and the impacts on the utilities revenues and operations are insignificant. Demand response and efficiency programs have the same impacts as DG and yet those are acceptable. Solar generated energy is a 21st century technology that is quickly evolving and one that our state would be negligent for not supporting. Early adopters of technology take risks to vet the benefits that later adopters eschew. Other examples are hybrid car owners and on-line shoppers who pay less gasoline or sales taxes, but eventually the rules will change to pay for the services we all depend upon. When solar generated energy reaches a certain penetration of the market, it might make sense to change the formula, but



given the low penetration levels anticipated the current policy serves to discourage business innovation, job creation and private property rights to control the amount of electricity we use.

With respect to the cost shift statements, the report does not provide enough evidence to state as a fact and there needs to be further analysis to make the claim. Infrastructure has been paid through years of rates and generally speaking it is a sunk cost. Other benefits of solar can be offsetting attributes and the report does not attempt to square the benefits and cost to make a cost shift statement.

Solar energy has no fuel cost, very low operating cost, declining capital costs and results in fixed cost power for up to 25 years. In a rising rate environment citizens ought to have a choice.

In closing we commend the work of the EAC to provide a useful narrative of the issues that higher levels of solar generation may have. What stands out is that the capacity of solar today and for the foreseeable future in South Carolina is infinitesimal relative to mainstream generation. The benefits of third party financing in greater adoption of solar generation, job creation, personal property rights and business activity is an opportunity to embrace.

Sincerely,

(signed) “*Grant Reeves*”

Grant Reeves

President – South Carolina Solar Business Alliance, LLC