BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON RENEWABLE ELECTRICITY STANDARD PROPOSED REGULATION ORDER

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I. INTRODUCTION AND SUMMARY

The Southern California Public Power Authority ("SCPPA")[1] respectfully submits this comment on the Proposed Regulation Order "California Renewable Electricity Standard" issued on June 2, 2010 for a 45-day comment period commencing on June 7 ("Proposed RES Regulation").

The SCPPA members support regulations designed to achieve the 33 percent renewable energy target in an efficient and cost-effective manner.

SCPPA commends the fact that the Proposed RES Regulation allows unlimited use of tradable renewable energy credits ("RECs") for the purposes of compliance with the Proposed RES Regulation. This is a sensible approach that will help control the costs of the 33 percent target to California energy consumers.

However, the Proposed RES Regulation does not address some issues which are important to SCPPA members. In summary, SCPPA recommends the following changes to the Proposed RES Regulation:

- The definition of "REC" states that RECs are not property. This provision is unnecessarily broad and will affect confidence in the REC market. The definition should be amended to protect the ARB's ability to change the rules of the RES program in the future, without paying compensation, while still allowing RECs to be property for most purposes.

[1] SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Imperial Irrigation District, Pasadena and Riverside.

- It should be clarified that RECs generated from RES Qualifying POU Resources after the expiration of the procurement contract for that resource are ineligible for compliance, but RECs generated from that resource prior to expiration of the contract remain eligible.
- Compliance intervals should remain at three years rather than dropping to two years and then one year. Longer compliance periods provide important flexibility for utilities that invest in their own renewable energy projects or purchase RECs and power directly from renewable energy projects rather than buying RECs on the secondary market.
- The Proposed RES Regulation should incorporate the flexibility provisions in Senate Bill ("SB") 722, as amended. These provisions allow extensions of time for compliance if renewable energy is unavailable due to circumstances beyond the control of the regulated party. This is particularly important for utilities that invest in their own projects.
- The deadline for retiring RECs to meet the RES Obligation should be nine months, not three months, after the end of each compliance interval to allow regulated parties enough time to calculate their exact REC liability and to procure the necessary RECs.
- The 20 percent limit on the use of RECs from RES Qualifying POU Resources should be calculated with reference to the POU's retail sales in the relevant compliance interval, rather than retail sales in 2010 only. Using a limit based on one year's sales rather than three (for a three-year compliance interval) would substantially reduce the number of such RECs that can be used and may increase compliance costs.
- Given the increased importance of the REC market in meeting compliance obligations under the RES, market oversight and control mechanisms should be developed to avoid market abuse and increase transparency. At a minimum, market operation should be added to the list of items to review in the periodic regulation review.

As a separate issue, it may be beneficial for both renewable energy producers and compliance entities if a double-sided auction or exchange platform for RECs is established.

SCPPA's comments are set out in detail below in the order in which issues arise in the Proposed RES Regulation.

II. DEFINITIONS SHOULD BE REVISED.

A. Definition of REC should have a narrower "property rights" exclusion.

The definition of "REC" in section 97002(a)(16) includes a statement that a REC does not constitute property or a property right. This is contrary to the treatment of RECs in the REC market and in contracts for the sale or purchase of renewable energy and RECs.

Without any property rights in RECs, a purchaser's remedies might be limited to those that are contractual in nature. For example, if a generator with a contract with a purchaser transferred RECs to a third party instead of the purchaser, the purchaser might not be able to enjoin the third party, because they are not in privity. This is likely to reduce confidence in the REC market.

If the ARB's concern is to retain flexibility to change the rules of the RES program in the future without triggering Due Process or Takings concerns, defining RECs as "not property" is an unnecessarily broad approach. The ARB could retain flexibility to re-define certain rights associated with RECs (for example, by changing the three-year REC banking/retirement period to a two-year or twenty-year period, by distinguishing between different sources of renewable energy, or by distinguishing between in-state and out-of-state generation) by conditioning the "investment-backed expectations" of market participants upon such future regulatory/legislative action.

The proposed changes to section 97002(a)(16) below allow for flexibility while retaining the "property" status of RECs for most purposes. This would support purchasers' ability to enforce remedies against third parties and increase confidence in the REC market.

> "**Renewable Energy Credit or REC**" means a transferable attribute associated with one MWh of electricity generated by an eligible renewable energy resource. A REC does not include an emission reduction credit issued pursuant to Health and Safety Code section 40709. A REC also does not include any allowance issued pursuant to a cap and trade or similar program. A REC does not constitute property or a property right for the purposes of any Takings or Due Process analysis under the Constitution of the United States of America or under the Constitution of the State of California. ARB reserves the right to prospectively alter or amend the definition of a REC (except for RECs banked in accordance with section 97005) as it is used for demonstrating compliance with this Article.

B. RECs that were generated from RES Qualifying POU Resources before the contract expired should remain eligible.

Section 97002(a)(19)(B)(3) provides that RECs procured from an RES Qualifying POU Resource become ineligible for compliance with the RES and must be replaced upon expiration of the contract for the purchase of energy from the RES Qualifying POU Resource.

While SCPPA accepts that eligible RECs should not be generated by the resource after expiration of the contract, it is not appropriate to require the replacement of RECs that were generated *before* expiration of the contract – particularly RECs that have already been retired for RES compliance purposes. A REC generated from such a resource before expiration of the contract is a megawatt hour of renewable energy, and that renewable energy should not retrospectively be deemed not to have been generated once the contract expires. This would virtually negate the value of having RES Qualifying POU Resources at all.

Section 97002(a)(19)(B)(3) should be amended as follows, to allow RECs that were generated before the contract expired to remain eligible for RES compliance:

~~Upon expiration of a procurement contract under subsection (B) above,~~ RECs procured from a RES Qualifying POU Resource and associated with power generated after expiration of a procurement contract under subsection (B) above shall not ~~longer be~~ eligible for compliance with the RES and shall be replaced with RECs from an eligible renewable energy resource under subsection 97002(a)(8)(A) or (B).

C. Definition of RPS should refer to POU RPS regulation.

In section 97002(a)(17), the definition of "Renewables Portfolio Standard or RPS" refers only to Public Utilities Code section 399.11. However, this section of the Code does not cover publicly owned utilities ("POUs"). See section 399.12(g)(4)(C) of the Code. It is evident that the definition of RPS in the Proposed RES Regulation is intended to apply to POUs, as the definition of RES Qualifying POU Resource refers to POUs' RPS eligible generation.

A different section of the Code, section 387, requires POUs to set renewable portfolio standards. This section should be referred to in the definition of RPS, as follows:

"**Renewables Portfolio Standard**" or "**RPS**" means the Renewables Portfolio Standard as set forth in Public Utilities Code section 399.11 et seq and section 387 in respect of POUs.

D. Formula for RES Obligation should include reference to MWh.

In section 97004(a), the formula for calculating an entity's RES Obligation does not specify what units should be used for the sum of retail sales. Megawatt hours are specified in the formulae in sections 97004(b) and (c) and are mentioned in the formulae in the ARB staff's Initial Statement of Reasons for the Proposed RES Regulation (page VIII-6). This unit should also be specified in section 97004(a) for clarity, as using a different unit will affect the size of the RES Obligation:

RES Obligation = Sum of sales to retail end-use customers for the compliance interval in MWh x the REC percentage for the compliance interval.

III. COMPLIANCE INTERVALS SHOULD REMAIN THREE YEARS.

At the RES workshop on May 20, 2010, ARB staff stated that three-year compliance periods are not required after 2020 as the REC market will be sufficiently liquid by that time to enable compliance entities to purchase RECs annually for compliance.

As the REC market is of limited size, it may never become very liquid. However, regardless of the liquidity of the market, many utilities (particularly POUs) plan to establish their own renewable energy projects for compliance with their RES obligations instead of relying on the market. POUs tend to self-supply electricity and may do the same with RECs. If they do not invest in their own renewable energy projects, POUs tend to purchase power and RECs directly from renewable energy projects, often without delivery guarantees or liquidated damages for failure to generate RECs or power. This leaves the POUs with the risk of project delays or under-performance. Purchasing RECs on the spot market or under guaranteed-delivery contracts is more expensive.

As an example, one SCPPA member intends to satisfy a substantial portion of its renewable energy requirement through a contract signed with a geothermal resource that is in early development, with no guarantee of power and REC delivery. Projects of this nature are subject to considerable risk of delay or a change in parameter, both prior to and after commissioning, for various geological reasons.

Multi-year compliance intervals provide an important source of flexibility for utilities that develop their own projects or otherwise bear project risks. Multi-year compliance intervals allow time for utilities to develop, repair, or replace renewable energy projects and to average out periods of variable REC generation.

Dropping to one-year compliance intervals from 2020 would make it risky for a utility to rely on its own renewable energy plants or on non-guaranteed contracts with plant owners to

generate the RECs it needs, given that both the number of RECs generated by a plant and the number of RECs a utility requires may vary greatly from year to year. To reduce the risk of non-compliance, utilities would be forced to buy RECs at a higher price on the secondary market or under guaranteed-delivery contracts. For these reasons, the ARB should reconsider its decision to drop compliance intervals to one year from 2020 and instead retain three-year compliance intervals.

Retaining three-year compliance intervals need not affect the upward trajectory of percentage renewable energy requirements that the Proposed RES Regulation currently specifies. It is possible to have different percentage renewable energy requirements for different years within the same compliance interval. Section 97004(a) of the Proposed RES Regulation provides a 28 percent target for the two-year compliance interval 2018-2019 and a 33 percent target for the one-year interval 2020. SCPPA proposes a three year compliance interval, 2018-2020, while retaining the renewable energy percentages proposed in section 97003. Thus, after the end of 2020 a regulated entity would calculate its total REC obligation for the compliance interval as 28 percent of its 2018 and 2019 retail sales, plus 33 percent of its 2020 retail sales.

The requirement in section 97006(c) to provide annual progress reports would ensure the availability of the data needed to calculate total REC requirements for the three-year compliance interval.

The table in section 97004(a), "Compliance Intervals and REC Percentages", would need to be amended as follows:

Compliance Intervals	REC Percentage
2012 through 2014	20
2015 through 2017	24
2018 through 2020~~19~~	For 2018-2019: 28 For 2020: 33
2021 through 2023,~~0~~ and each three-year interval~~annually~~ thereafter	33

IV. EXTENSIONS OF TIME FOR COMPLIANCE SHOULD BE GIVEN IN CERTAIN CIRCUMSTANCES.

For the same reasons as are set out above regarding three-year compliance periods, it is important to provide some flexible compliance options when a utility is unable to meet its RES Obligation through no fault of its own.

Flexible compliance provisions have a well-established precedent in renewable energy standards. The RPS regulations (sections 399.11-399.20 of the Public Utilities Code) as well as the extension to the RPS proposed in SB 722 allow flexibility in complying with the renewable energy targets in certain situations. Specifically, SB 722 would allow extensions of up to two years in meeting the targets if:

- There is inadequate transmission capacity to allow for sufficient electricity to be delivered from proposed eligible renewable energy resource projects;
- There are unanticipated permitting, interconnection, or other delays for procured eligible renewable energy resource projects; or
- There is an insufficient supply of delivered electricity from eligible renewable energy resources available to the retail seller. SB 722 proposed section 399.15(b)(5) of the Public Utilities Code (June 22, 2010).

As the renewable energy targets increase, these grounds for extensions become increasingly pertinent for POUs that invest in their own renewable energy projects, or otherwise take project risk, as compared to utilities that purchase RECs on the secondary market or under guaranteed contracts. For example, if, as in the case mentioned above, one of the SCPPA utilities uses its best efforts to ensure that the geothermal project on which it relies delivers RECs in time to allow that POU to meet its compliance deadline, but the geothermal project fails to operate as planned through no fault of the POU, the POU should not be penalized or required to enter the

TREC market at a potentially higher price. Instead, it should be given an opportunity to procure the missing RECs over an extended period.

The flexibility provisions proposed in SB 722, as summarized above, should be incorporated into section 97004 of the Proposed RES Regulation.

V. ALLOW NINE MONTHS AFTER THE END OF A COMPLIANCE PERIOD BEFORE RECS ARE DUE.

According to the definition in section 97002(a)(4), the deadline to retire RECs for compliance in respect of a compliance interval, the "Compliance Deadline", would be March 31 of the year following the end of each compliance interval. Three months is not enough time to finalize year-end retail sales figures and obtain any additional RECs that might be required by higher than expected sales. Additionally, as noted above, the volume of RECs received from any particular renewable energy project may vary considerably each year, making it difficult to accurately forecast deliveries of RECs. Unless an entity has banked RECs in excess of its liability, it may take some time to obtain the total volume of required RECs after the end of a compliance period.

Therefore, regulated entities should be given a period of nine months from the end of each compliance interval before the full number of RECs must be retired. This would be consistent with the period proposed for the retirement of allowances in the Preliminary Draft Regulation for the California Cap and Trade Program. Regulated entities need this period to determine their exact liability and to obtain RECs if they do not have enough.

This change should be reflected in section 97002(a)(4) as follows:

> "**Compliance Deadline**" means September 30~~March 31~~ of the year following the end of each compliance interval.

VI. LIMIT ON USE OF RECS FROM RES QUALIFYING POU RESOURCES SHOULD BE CALCULATED ON RETAIL SALES IN EACH COMPLIANCE INTERVAL.

Section 97005(c) of the Proposed RES Regulation provides that a POU can use RECs from a RES Qualifying POU Resource ("POU RECs") towards its RES Obligation up to a limit of 20 percent of the POU's retail sales during calendar year 2010. For example, if a POU's 2010 retail sales were 800,000 MWh, it could use a maximum of 160,000 POU RECs for RES compliance in any one compliance interval.

The two previous drafts of the RES Regulation, released on March 11 and May 14, 2010, both allowed use of POU RECs for up to 20 percent of the POU's retail sales, presumably for the whole of the compliance interval in question. For example, if a POU's retail sales over a 3-year compliance interval were 2.4 million MWh (an average of 800,000 MWh/year), it could use a maximum of 480,000 POU RECs. This approach is logical because it uses the same basis for calculation as the RES Obligation that forms the core of the RES Regulation: total retail sales over the compliance interval.

Tying the ceiling on POU RECs to one year's retail sales has the effect of substantially reducing the number of POU RECs that can be used in a 3-year compliance interval: from 480,000 to 160,000, assuming retail sales of 800,000 MWh per year. SCPPA is not aware that any reason for this significant reduction has been put forward.

Reducing the number of POU RECs that can be used may increase the cost to POUs – and consumers – of complying with the RES regulation.

The position in the earlier drafts of the regulation should be reinstated, and section 97005(c) should be revised as follows:

> RECs procured from a RES Qualifying POU Resource may be used by the initial POU owner or procurer for up to the amount of its RES Obligation equal to 20 percent of its retail sales to end-use

customers during the compliance interval for which its RES Obligation is being calculated~~calendar year 2010~~.

VII. ENFORCEMENT PROVISIONS SHOULD BE MODIFIED.

Section 97009(b) of the Proposed RES Regulation states that "A violation of the requirements of this Article shall be deemed to result in an emission of an air contaminant." While it may be considered that failure to retire sufficient RECs constitutes a form of emission of an air contaminant, late submission of reports cannot reasonably be considered to constitute emission of an air contaminant. The reference to air contaminants should apply only in relation to non-retirement of RECs.

Section 97009(b) should be revised as follows (including some additional changes for clarity):

> (b) *Violations*. ~~A violation of the requirements of this Article shall be deemed to result in an emission of an air contaminant.~~
>
> (1) ~~Each day or portion thereof that a Regulated Party violates or remains in violation of a requirement of this Article is a separate violation.~~ Each day or portion thereof that any report required by this Article remains unsubmitted, is submitted late, or contains incomplete or inaccurate information, shall constitute a separate violation of this Article.
>
> (2) If a Regulated Party fails to retire a sufficient number of WREGIS certificates to meet its RES Obligation by the Compliance Deadline~~date specified in section 97004~~, there is a separate violation of this Article for each required WREGIS certificate that has not been retired by the Compliance Deadline. Such violations shall be deemed to result in emission of an air contaminant. There is also a separate violation for each day or portion thereof after the Compliance Deadline that each required WREGIS certificate has not been retired.
>
> (3) Each day or portion thereof that a Regulated Party violates or remains in violation of any other requirement of this Article is a separate violation.

SCPPA also looks forward to seeing the example penalty calculations that ARB staff proposed to provide.

VIII. REC MARKET OVERSIGHT MECHANISMS SHOULD BE INTRODUCED.

The REC market will play an increasingly important role in allowing compliance entities to meet their RES targets. Therefore, market oversight and control mechanisms should be developed to avoid market abuse. Attention is being paid to developing such measures for the trading in allowances under the California emissions cap and trade program and also under the Western Climate Initiative emissions cap and trade program.[2] These measures may provide a guide to the types of market oversight measures that should be considered for the REC market.

A. Increase transparency of the REC market.

Increasing the transparency of the REC market is an important first step. It will lower transaction costs and thereby assist smaller compliance entities to participate in the market. Also, it will provide the information necessary to identify and address market manipulation.

As an example, the South Coast Air Quality Management District publishes detailed information on the trading of RECLAIM Trading Credits, including seller and buyer names, quantity sold, type of credit, price, and transaction date.[3] Public reporting such as this, by a regulatory body, would be a very useful transparency tool for the REC market.

B. Include market reviews as part of the regulation reviews.

At the May 20 workshop on the Proposed RES Regulation, ARB staff noted that they would look at how well the REC market is functioning as part of the regulation reviews to be conducted under section 97011. This would be helpful, although it would not be sufficient on its own. However, section 97011(b), which lists the issues that the regulation reviews should

[2] See for example the April 2010 WCI paper entitled "Market Oversight Draft Recommendations", available at http://westernclimateinitiative.org/components/com_publiccomments/documents/Market_Oversight_Draft_Recommendations.pdf.

[3] This information can be found at http://www.aqmd.gov/reclaim/rtc_main.html at the link "Listing of Trade Registrations".

include, does not specifically mention REC market functioning. Given the importance of reviewing REC market functioning, section 97011(b) should be amended as follows:

> (4) Availability and supplies of eligible renewable resources and ~~renewable energy credits~~RECs within the WECC, including consideration of how well the REC market is operating and whether any market manipulation has occurred;

IX. A REC AUCTION OR EXCHANGE WOULD BE BENEFICIAL.

Although this need not be reflected in the RES regulation, it would be beneficial if a double-sided auction or other form of transparent exchange for RECs were established. Such a forum could be established by a private entity on a for-profit basis, or (preferably) by an independent non-profit entity such as the California Independent System Operator. The ARB's decision to allow unlimited use of tradable RECs provides a further impetus for the establishment of such a forum.

Currently renewable energy developers are required to enter into bilateral agreements to sell their RECs (which may or may not include the sale of power). Such agreements can have high transaction costs and do not provide a transparent price signal for RECs. Small renewable energy projects may have difficulty negotiating an advantageous REC sale agreement. Similarly, small compliance entities that do not generate all of their required renewable energy themselves may have difficulty sourcing RECs at competitive prices.

If a double-sided auction or exchange for RECs is developed, renewable energy developers would have the option of selling their RECs using this forum rather than entering into bilateral agreements. The existence of such a forum may assist small renewable energy developers to obtain finance for their projects by providing a source of credible information on the value of RECs and an accessible way to monetize them. It would also provide a simple and transparent method for compliance entities to access the REC market.

Such forums are not unprecedented. PJM EnviroTrade, a subsidiary of PJM Interconnection, a US regional transmission organization, is establishing double-sided auctions for renewable energy certificates from solar power projects in New Jersey, Pennsylvania, Ohio, Maryland, and the District of Columbia. The first of the monthly auctions is set to take place in July, 2010. The auctions will serve the compliance and voluntary REC markets.[4] PJM EnviroTrade may be able to provide assistance in establishing a similar forum in California.

X. CONCLUSION

SCPPA urges the ARB to consider these comments when making its decision on the RES regulation. SCPPA appreciates the opportunity to submit these comments.

Respectfully submitted,

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[4] See www.pjmenvirotrade.com. PJM EnviroTrade is running a series of webinars in July on its renewable energy certificate auctions – details are available at http://www.pjmenvirotrade.com/training/training.html.