SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT
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July 14, 2010

**The Honorable Mary Nichols, Chairman**
**Mr. James Goldstene, Executive Officer**
**Mr. Dave Mehl**
**Mr. Gary Collord**
**California Air Resources Board**
**1001 I Street**
**Sacramento, CA 95814**

**Re: Proposed Regulation Order For California Renewable Energy Standard**

Dear Ms. Nichols, Mr. Goldstene, Mr. Mehl, and Mr. Collord,

Thank you for the opportunity to submit these comments on the Proposed Regulation Order For California Renewable Energy Standard (PRO RES). The Sacramento Municipal Utility District (SMUD) has participated throughout the development of the PRO RES, and appreciates the hard work of the Air Resources Board (ARB) staff, and their colleagues at the California Energy Commission (CEC) and California Public Utilities Commission (CPUC).

In summary, SMUD views the PRO RES as a viable regulatory basis for a cost-effective 33 percent RES. SMUD has the following areas of comment:

- The ARB should reconsider the Compliance Deadline, as WREGIS accounting for a compliance interval will not be completed by March 31 of the following year. SMUD recommends changing the Compliance Deadline to June 1.

- The ARB should allow for limited exceptions to the standard compliance structure, consisting of retirement of RECs through WREGIS. These exceptions would be for Eligible renewable energy resources that cannot easily create RECs because they are subject to Section 399.16(a)(5), and also potentially for Eligible renewable energy resources procured from the Western Area Power Administration (WAPA).

- The PRO RES should clearly provide that RECs created but not retired by a Regulated Party under the RPS prior to December 31, 2011 are eligible for use for compliance with the RES in 2012 and afterwards. Currently, the PRO RES is silent on pre-2012 RECs.

- The ARB should reduce unnecessary regulatory burden and cost by continuing with three year compliance intervals after 2020, and revising the reporting requirements in the post 2020 period.

- The ARB should change the proposed penalty structure for the RES to permit assessment of penalties only once at the conclusion of a compliance interval, rather than ongoing on a daily basis, and only based upon the quantity of renewable energy (in MWh) below the RES Obligation that a Regulated Party has failed to procure. The current model of daily penalties from the Health and Safety Code is arbitrary and does not incentivize procurement in a feasible manner.

SMUD expands upon these principal points, and related matters, in the following detailed comments.

## A. 97002. Definitions and Acronyms

**"Compliance Deadline"** The new term "compliance deadline" in the PRO RES is useful to define, but is problematic as defined. A compliance deadline of March 31 in the year following the end of each compliance interval does not provide sufficient time in SMUD's experience for all WREGIS transactions to be final for the compliance interval. SMUD often is still receiving WREGIS confirmation of transactions into May of the year following the transaction. SMUD recommends that the definition of compliance deadline be revised to provide for compliance by June 1, rather than March 31, of the year following the end of each compliance interval. SMUD believes that there is sufficient time between the proposed June 1 Compliance Deadline and the July 1 reporting requirement to allow for compliance reports to proceed as envisioned. SMUD requests that the compliance deadline definition read:

> "**Compliance Deadline**" means June 1~~March 31~~ of the year following the end of each compliance interval.

**"Eligible renewable energy resource"** The definition of eligible renewable energy resource in the PRO RES has changed slightly from the earlier definition in the RES PDR and the change has inadvertently added some confusion. For clarity, the definition should read:

> **"Eligible renewable energy resource"** means a generating facility participating in the WREGIS tracking system that meets one of the following criteria ~~is~~:
>
> (A) Certified as eligible for California's RPS program pursuant to

Public Utilities Code section 399.13;
(B) Meets the criteria of the California RPS program, excluding electricity delivery requirements, as determined by ARB; or
(C) Is a RES Qualifying POU Resource as defined in, and limited by, this Article.

"**Large hydroelectric generation"** The PRO RES has added a definition of large hydroelectric generation that is not consistent with the common definition of the eligibility of small hydro resources as renewable in California, and hence is inconsistent with the definition of "eligible renewable energy resource" in the PRO RES. Eligible small hydro in California is defined as "30 MW or less", and the PRO RES large hydro definition should not include the exact number "30" in the definition, to avoid confusion. SMUD's proposed change is:

> **"Large hydroelectric generation"** means a hydropower generating facility with a larger than 30 MW ~~or larger~~ generating capacity and which otherwise does not meet the definition of a small hydroelectric facility as described under Public Utilities Code section 399.12; and/or is not recognized as an eligible resource for the RPS program as set forth in Public Utilities Code section 399.11 et seq.

"**Renewable Energy Credit or REC"** – The proposed definition of a Renewable Energy Credit or REC is similar to the current statutory definition in Public Utilities Code section 399.16, with two problematic additions. The proposed regulation adds sentences defining a REC as not including *"…any allowance issued pursuant to a cap and trade or similar program,"* and asserting that *"…a REC does not constitute property or a property right."* In addition, the definition asserts that: "*ARB reserves the right to alter or amend the definition of a REC as it is used for demonstrating compliance with this article."*

This definition remains very similar to the definition provided in the preliminary draft regulation, and SMUD reiterates its earlier recommendation that the definition of a REC should more closely track the definition in current law, codified at Pub. Util. Code 399.12(f), with the exception that a RES REC is eligible despite the electricity delivery requirements in the RPS program – an exception that SMUD supports. As mentioned in SMUD's comments on the preliminary draft regulation, increased generation of renewables does not add to GHG emissions and in fact causes a reduction in fossil fueled generation somewhere in the Western Electricity Coordinating Council (WECC). As a result, there is an environmental attribute – zero GHG emissions from the underlying resource that generally leads to a reduction in GHG emissions elsewhere – associated with the generation of a REC. While SMUD acknowledges that the RES program may not be the appropriate place to credit the reduction in GHG emissions, it is premature for ARB to make a statement in the definition of a REC in the RES program that forestalls or prohibits a REC from carrying an environmental attribute in the form of GHG reduction. Current law provides that a REC "includes all renewable and

environmental attributes associated with the production of electricity from the eligible renewable energy resource …" If any cap-and-trade program subsequently assigns a zero carbon signature or value to a REC, the sentence in the current definition, "A REC also does not include any allowance issued pursuant to a cap and trade or similar program", may, at a minimum, cause confusion, and possibly be in conflict with that definition.

In addition, ARB has removed a segment of the current REC definition in law which will change how the market perceives RECs from biogas and biomass resources – the phrase that says that RECs do not include: "… any credits or payments associated with the reduction of solid waste and treatment benefits created by the utilization of biomass or biogas fuels." Again, SMUD recommends that the definition of a REC for the purposes of the RES include the "biomass and biogas" phrase in existing law to avoid changes in how the market will perceive biomass and biogas sourced renewables.

Finally, as SMUD has previously commented, changing the REC definition significantly from current law could open up contractual issues in currently signed contracts. RECs in contracts are now purchased as property rights, whether in POU or IOU contracts, and when fully implemented by the CPUC, will be traded as property. Asserting that RECs do not constitute property rights is contractually problematic, and would create further separation between RPS RECs and RES RECs.

Accordingly, SMUD recommends that the REC definition in the RES PDR read as follows:

> **"Renewable Energy Credit or REC"** means a certificate of proof issued by WREGIS that one MWh of electricity was generated by an eligible renewable energy resource or facility as evidenced by a Renewable Energy Certificate. A REC does not include an emission reduction credit issued pursuant to Health and Safety Code section 40709 or any credits or payments associated with the reduction of solid waste and treatment benefits created by the utilization of biomass or biogas fuels. ~~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.~~ARB reserves the right to alter or amend the definition of a REC as it is used for demonstrating compliance with this Article.

**"RES Qualifying POU Resource"** – The PRO RES includes a refined definition of "RES Qualifying POU Resources" in response to comments and further consideration by staff. The revised definition in the PRO RES has two small issues. First, the revised definition drops a clause about meaning "… *a renewable energy facility that is not certified by the CEC as eligible for the RPS program, …"* and includes a circular reference between the definition and the definition of "Eligible renewable energy resource". This could cause confusion that all POU resources, even those that are considered eligible for the state's

RPS definition, might be considered "RES Qualifying POU Resources" and subject to the constraints included in the definition. Second, clause (3) of the definition suggests that when RES Qualifying POU Resource contracts expire, the resource '… shall be replaced with RECs from an eligible renewable energy resource …". SMUD believes that it is sufficient to end the clause with the statement that after expiration these resources are no longer eligible. If an entity needs additional RECs for compliance, it is implied that they will purchase or otherwise acquire them, but if an entity does not need additional RECs for compliance, then there should be no requirement that the expired eligibility needs to be replaced by additional RECs.

> **"RES Qualifying POU Resource"** means a renewable energy resource that does not meet the definition ~~as defined~~ in section 97002(a)(8)(A~~C~~), whose electrical generation was both approved by the POU's Governing Board and reported to the California Energy Commission, as contributing towards the POU's RPS eligible generation on or after January 1, 2003, and prior to September 15, 2009, and:
>
> (A) The POU owned the facility prior to or after January 1, 2003, and prior to September 15, 2009, or
>
> (B) Procured the electricity from the facility by contract executed prior to September 15, 2009; and:
>
> (1) The POU procured electricity and RECs, or RECs without electricity; and
>
> (2) The electricity was procured under the terms of the contract in effect on or before September 15, 2009, and not during any contract term extended or modified after that date.
>
> (3) Upon expiration of a procurement contract under subsection (B) above, RECs procured from a RES Qualifying POU Resource shall no 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)~~.

"**WREGIS Certificate**" The PRO RES has a revised definition of a WREGIS Certificate, referring explicitly to the " … WREGIS operating rules in effect at the time of the adoption of this Article, representing a REC." SMUD believes that this definition will prove constraining over time, potentially requiring updating of the RES regulations as WREGIS operating rules change. SMUD recommends that the ARB consider returning to the previously stated definition of a WREGIS Certificate", namely:

"**WREGIS Certificate**" ~~means a WREGIS certificate as defined in the WREGIS operating rules in effect at the time of the adoption of this Article, representing a REC~~ means a certificate of proof issued through WREGIS that one MWh of electricity was generated by a RES eligible renewable energy resource.

**B. 97004. Renewable Energy Standard Obligations.**

SMUD suggests several changes in Section 97004, which lays out the basic percentages and compliance intervals for the proposed RES regulation.

First, SMUD notes that we have recommended a change in the definition of "Compliance Deadline", a term which is referenced in Section 97004, so that the deadline for retiring RECs for a compliance interval is June 1 of the following year, rather than March 31. As SMUD has noted earlier, final WREGIS results for a year are often not available even in May of the following year, so absent this change in the compliance deadline, SMUD believes that the requirement in Section 97004 of retiring WREGIS certificates for the purpose of demonstrating compliance with the RES will of necessity be preliminary in nature, until final WREGIS results are received. In addition, SMUD believes that extending the compliance deadline as recommended will allow for additional flexibility to use RECs, to the extent available from WREGIS, from the next compliance period for compliance with the previous period's obligation. While this flexibility is limited to RECs that are generated and WREGIS certified by the compliance deadline, allowing up to 5 months of such transactions into the next compliance period rather than 3 months represents much needed flexibility.

Second, SMUD understands and supports the basic structure of the RES where eligible WREGIS RECs are retired to establish compliance. This structure should be the main form of compliance for the RES and should work for all new renewable development as well as most existing renewable generation. However, there are some existing renewable generators that are under relatively old long-term contracts -- contracts signed prior to the clear existence of RECs. Generators under a contract signed prior to 2005 that does not include explicit provisions about RECs are prohibited by law (PUC 399.16(a)(5)) from creating RECs for the RPS as part of their generation, yet are considered to be part of utility RPS portfolios. These resources will be part of utility RPS portfolios – and by extension should be part of their RES portfolios – until the end of their contract periods, when RECs can be explicitly considered in new contracts. SMUD has one resource that, while fully part of its renewable portfolio, has not agreed to provide RECs to SMUD in recent years. The ARB should include an exception for these types of facilities, as follows:

> Except as provided in Section 97003, each Regulated Party (other than DWR and WAPA) shall retire an amount of WREGIS certificates, or provide

equivalent evidence of generation from Eligible renewable energy resources that are subject to PUC Section 399.16(a)(5), sufficient to demonstrate compliance with the Regulated Party's RES Obligation for each compliance interval. Compliance intervals and the associated REC percentages are specified in Table 1. WREGIS certificates or equivalent evidence of energy from PUC Section 399.16(a)(5) resources retired for the purpose of demonstrating compliance with the RES Obligation for each compliance interval shall be retired no later than the Compliance Deadline for each compliance interval.

Similarly, ARB may need to consider an exemption process for Eligible renewable energy resources procured from WAPA, as WAPA may not easily certify or allow to be certified RECs from Eligible renewable energy resources that they own and sell to other Regulated Parties.

Third, SMUD continues to suggest that 3-year compliance periods be continued beyond 2020, as the need for compliance flexibility beyond 2020 to help deal with hydro variability and the lumpy nature of much renewable procurement does not go away. SMUD recommends changing Table 1 as follows:

**Table 1. Compliance Intervals and REC Percentages**

| Compliance Intervals | REC Percentage |
|---|---|
| 2012 through 2014 | 20 |
| 2015 through 2017 | 24 |
| 2018 through 2019 | 28 |
| 2020 through 2022 and every 3 years thereafter | 33 |

Finally, SMUD continues to support consideration of additional flexible compliance mechanisms beyond those reflected in the PRO RES to reflect those circumstances beyond the control of utilities and other regulated parties that could result in a shortfall of resources or a delay in compliance under the RES. SMUD believes that CARB could recognize these situations and provide additional flexibility in the transition between compliance periods by adding provisions in the reporting and penalty provisions of the PRO RES, as described later in these comments.

### C. 97005. Renewable Electricity Standard Requirements

SMUD believes that allowing banking of RECs as proposed in Subsection (d) of Section 97005 RES PDR is an important flexibility mechanism, and understands that under the proposed regulation order that RECs can be banked *or traded* for RES purposes for up

to three years, but then can no *longer be traded to other RES obligated entities for RES use*, but rather must be used or banked for the RES to remain RES eligible.

SMUD suggests that an additional provision be added to Subsection (d) to clarify the status of RECs that are created prior to the start of the RES Obligation in 2012. As ARB understands, entities that will be subject to the RES are currently subject to one degree or another to RPS requirements, overseen by the CPUC in the case of the IOUs and by individual public boards in the case of the POUs that have adopted RPS policies. In order to seamlessly transition from RPS obligations in 2011 and earlier to a combined RES and RPS obligation in 2012 and on, ARB must clearly state the rules for use of pre-2012 RECs for RES obligations in 2012 and subsequent years.

SMUD contends that excess RECs from a pre-2012 RPS perspective – that is, RECs generated but not retired for compliance with an RPS obligation prior to 2012, should be considered available for the combined RES and RPS obligation post 2011. Following the general REC banking and trading rules described in Subsection (d) means that any such RECs would have to have been issued by WREGIS and would have to be less than three years old or have already been retired and banked for RPS purposes to be eligible for the RES. This limits the amount of pre-2012 RECs that can be used for the RES, while providing incentives for continued increases in renewable generation prior to the effective date of the RES in 2012 and allowing for a smooth juxtaposition of RES and RPS obligations. Failure to clearly consider these RECs could lead to a situation where an entity is fully compliant with the RPS, using banked RPS RECs, but is considered non-compliant with the RES in 2012-2014. SMUD recommends the addition of the following provision:

> [97005(d)] (5) RECs generated prior to 2012 may be banked and traded for RES compliance subject to the provisions of this Subsection.

Finally, SMUD contends that the statement at the end of Section 97005(d), that: "*Nothing in this subsection (d) shall be construed to limit the use, banking, or trading of RECs not use to meet RES Obligations under this Article*", should be given a separate subsection heading and expanded to include the provisions of subsection (c), which limit the use of RECs from RES Qualifying POU Resources under the proposed RES. SMUD recommends the following language:

> [97005] (e) Nothing in ~~this~~ subsection (c) or subsection (d) shall be construed to limit the use, banking, or trading of RECs not use to meet RES Obligations under this Article

**D. 97006. Monitoring, Verification, and Compliance**

SMUD supports monitoring and verification requirements to ensure that all regulated parties are appropriately participating and complying with the proposed RES. In general, the requirements laid out in the PRO RES appear reasonable, though in order to reduce regulatory cost and burden, SMUD prefers a requirement for filing compliance interval reports every three years (as well as three year compliance periods)after 2020. Should annual compliance periods remain, however, SMUD has some specific comments, as described below.

First, if the ARB establishes annual compliance periods after 2020, rather than continuing with triannual periods as recommended, SMUD sees no reason why the ARB should require both an Annual Progress Report as described in Subsection (c) as well as an annual Compliance Interval Report as described in Subsection (d). SMUD recommends continuation of three year compliance periods, with commensurate changes to subsection (d) – substitution of 'every three years' for 'annually' in the text. However, should the ARB establish annual compliance periods after 2020, SMUD recommends eliminating the Annual Progress Report after that year, as follows:

> (c) Filing of Annual Progress Reports. Beginning July 1, 2013 and July 1st of each year thereafter through 2020, each Regulated Party, except those exempted by section 97003 and DWR and WAPA, shall submit the following information for the prior calendar year…

Second, in Subsection (d), SMUD notes that consistency with other sections would ask for contact information for the Responsible Official, and also, should annual compliance periods be maintained after 2020, questions the need for a Project Status Report after that year. SMUD recommends the following changes:

> [97006(d)(1)] (B) Name and contact information of Responsible Official for entity; and…
>
> [97006(d)(3)] Project Status Report
> Prior to 2021, A project development status report on any project development activities, including site control, permitting status, financing status, interconnection progress, and transmission access during the next compliance interval, consistent with the achievement plan submitted under 97006(b) above.

Third, SMUD believes that additional clarity would be useful in 97006(d)(4), which discusses reporting regarding a RES obligation deficiency. The proposed regulation here requests "a schedule to meet the shortfall within the current year." SMUD has two questions here. First, it is not clear whether the ARB expects the shortfall to be covered within the current calendar year, or within a year from the date of the compliance report

(July 1 to July 1). SMUD suggests that July 1 to July 1 makes more sense, because nearly half the current calendar year will have already transpired, and presumably RECs from that period already used for on-time compliance. Second, SMUD requests clarity that what is meant by "…meet[ing] the shortfall…" here is that current and future RECs – from essentially the next compliance interval – can be retired and designated for meeting the previous compliance interval's shortfall. Alternatively, ARB may mean that Regulated Parties should strive to find unretired RECs from the previous compliance interval and purchase and retire those RECs. SMUD contends that such unretired RECs may prove impossible to find. The general topic of how to designate a schedule to meet a shortfall, how a shortfall is to be met, and how this is to be enforced within some period ("… current year…") that is not covered in the enforcement language requires more clarity.

## E. 97007. Certification of Eligible Renewable Energy Resources

SMUD continues to contend that Section 97007 describes how certification can be done, but that neither the section nor any other part of the PRO RES actually requires certification. SMUD suggests that language be added to require certification, as the part of Subsection (a) of Section 97007. SMUD suggests the following language:

> (a) An Eligible renewable energy resource ~~may~~ shall be certified by any of the following: …

## F. 97009. Enforcement

SMUD is disappointed that the enforcement Section 97009 of the PRO RES does not develop a more appropriate penalty structure for the RES, such as has been signaled in the RES PDR. While SMUD agrees that the ARB must use its own penalty authority, rather than establishing a new enforcement and penalty structure with the CEC or some other agency, SMUD believes that for the RES to work effectively the penalty structure must be designed to reflect the nature of the RES requirement, rather than simply following the basic daily penalty structure established in Health and Safety Code section 38580. In the preliminary draft regulation for the RES, ARB indicated that violations of section 97004 – the basic RES obligation to cover a certain percentage of retail sales with renewable resources – would be calculated on a MWh basis, and did not explicitly signal the daily penalties that have now been added in Section 97009 of the PRO RES. This preliminary direction would have been an appropriate basis for a metric for MWh-based compliance over a multi-year compliance period. SMUD believes that an appropriate penalty structure should reflect the amount of MWh shortfall for which a regulated party is responsible, and may require that that shortfall be rectified, but would not establish a daily penalty for each MWh of shortfall until rectified. SMUD requests clarification and examples regarding the proposed regulatory structure, and consideration of the points below.

Clearly, Health and Safety Code Section 38580(b)(3) does not require daily penalties but permits ARB to tailor the penalty structure to fit the specifics of the regulation being violated. Daily penalties are appropriate for violations of hourly or daily compliance periods, such as hourly or daily emission requirements, but are wholly inappropriate for violations of annual or multi-annual procurement requirements such as the RES. Existing hourly or daily penalties follow the principle of repeating the penalty for each compliance period. That principle does not support applying a daily penalty to annual or triennial compliance periods.

Moreover, while it would be reasonable to establish a penalty for a MWh shortfall for the RES on a per/MWh basis, when that penalty is multiplied daily, it quickly becomes unreasonable in relation to the costs of the underlying MWh of renewable generation. SMUD encourages the ARB to find that per/MWh penalties for RES violations are sufficient, particularly if the violation is a shortfall in MWh that must be made whole with additional MWh within the current year, as described in Section 97006(d)(4).

The ARB should recognize that the ability to make a violation whole on a daily basis will be limited (related to the fact that this is an annual or multiannual obligation). A 1% shortfall in the RES Obligation for a 3-year compliance period is roughly equivalent to 10 days of generation, and if 19% of that generation is from renewables, it would take roughly 50 days to create sufficient RECs from under-contract or owned generation to rectify the shortfall with generation from the current compliance period.

Finally, when a manufacturing facility faces a daily penalty for violation of an emissions limit, the facility has the option of avoiding penalties by a temporary shutdown of the facility, if it could not find a way to come into immediate compliance. The same cannot be said of electric generation under the RES obligation. Shutting down power plants is simply not an option because Regulated Parties (as POUs or IOUs) have a primary duty to serve load. Procurement of new Eligible renewable energy resources takes a long time (either via lengthy contract negotiations or internal project development) and cannot be easily rushed to avoid prospective daily penalties. Additionally, it is unclear that Regulated Parties will be able to buy sufficient quantities of RECs on the market in a manner that complies with section 97005. Quick contracts for bundled renewable energy are not readily available because most renewable facilities are tied to long term contracts, and real-time RECs markets are not liquid because the economics do not yet exist to enable such premium priced resources to stand by and wait for demand to appear. As a result, renewable energy markets are fundamentally different than conventional manufacturing situations or even traditional energy markets and RES compliance cannot be similarly incentivized by daily penalties. However, if the prospect of daily compounding penalties is considered onerous enough, and the PRO RES makes that prospect a real concern, a Regulated Party could consider the extreme step of reducing conventional generation to avoid those penalties.

In summary, the ARB should avoid establishing daily penalties for the RES. The ARB could find a separate violation if the requirement in Section 97006(d)(4) to make whole within the current year is not met, or could establish a graduated penalty structure for more egregious violations of the RES, but should not simply establish daily additional violations for each MWh that remains a shortfall for the previous compliance period. SMUD recommends dropping the 'daily' language, as follows:

> [97009(b)] (2) If a Regulated Party fails to retire a sufficient number of WREGIS certificates to meet its RES Obligation by the 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. ~~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~~.

In addition, while SMUD understands that late or insufficient reporting for the RES should be subject to penalties as described in section 97009 (b)(1), SMUD believes that there should be explicit provisions for any reports that are deemed to be incomplete or inaccurate to be "made whole", based on explicit direction provided by the ARB and within a certain timeframe without penalty.

## G. Closing

In closing, SMUD again expresses its appreciation of the hard work by ARB staff in crafting the proposed regulatory order for the RES, and for the opportunity to submit these comments. We look forward to participating throughout the final stages of the RES regulations, and subsequent implementation.

Respectfully submitted,

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