3Degrees Bringing Climate Solutions Down To Earth

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April 8, 2010

Ms. Mary Nichols, Chairman
Mr. James Goldstene, Executive Officer
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: 3Degrees Comments on ARB Draft Regulations for a 33% California Renewable Electricity Standard

Dear Chairman Nichols and Executive Officer Goldstene:

3Degrees appreciates the opportunity to provide comments on the Draft Regulations for a 33% California Renewable Electricity Standard, released on March 11, 2010.

3Degrees commends California on its leadership in developing regulations to reduce greenhouse gas emissions, and particularly commends the State for the recognition that an aggressive 33% Renewable Electricity Standard (RES) is a critical complimentary policy in achieving the State's greenhouse gas (GHG) emission reduction goals under AB 32.

3Degrees believes that the challenge of global climate change and the State's GHG reduction goals can best be met by lowering the cost of compliance for regulated entities and increasing market liquidity for low and zero carbon renewable electricity generation. From that market perspective, we offer the following three comments on the Draft RES Regulation.

1. **Clarify that renewable energy credits (RECs) may be traded by both regulated and non-regulated parties.** Section 97004 (d) (2) states "RECs may only be traded by regulated parties who are in compliance with the REC retirement requirements of section 97003." 3Degrees believes that this sentence in no way restricts nor does it intend to restrict the ability of non-regulated parties to trade RECs, but it leaves room for misinterpretation due to unclear wording. We encourage ARB to clarify this sentence and state in the affirmative that the intent of the Draft RES Regulation is to allow non-regulated parties to trade RECs. As a parallel, the ARB Draft Cap and Trade Regulation released in 2009 does not restrict market participation and further defines "Opt-in Participants" as entities that can opt into the cap-and-trade system including traders, brokers, offset providers, and those who wish to voluntarily retire compliance instruments. The same logic should apply to the RES REC market.

   Although this issue is seemingly resolved, 3Degrees offers some brief supporting arguments for why non-regulated parties should be allowed to trade RECs in **Appendix A** below.

2. **Allow the unlimited use of unbundled and undelivered RECs, as described in Option 1 of Section 97004 (a).** Unlimited WECC-wide REC trading will maximize the availability of renewable resources to facilitate compliance with the RES at the least cost and maximize GHG reductions within the WECC. The CPUC's March 11, 2010 decision approving Tradable RECs for use in the RPS program is not the approach ARB should emulate. The CPUC's approach will lead to a severely constrained REC market. The CPUC's decision caps the use of RECs for investor owned utilities at 25% of APT and reclassifies previously eligible bundled transactions as "unbundled" tradable RECs (TRECs). The 25% TREC bucket will be largely filled up by these reclassified transactions, thus restricting the ability for truly unbundled and undelivered RECs to be traded. If ARB were to adopt this approach in the RES regulation it would put significant restrictions on the use of out-of-state generation to meet California's RES. It would also add unnecessary transaction complexity and reduce the ability of regulated parties to achieve the RES goals cost-effectively. Option 1 is a simple and straight forward approach to meeting AB 32 and RES goals.

3. **Prevent GHG leakage by requiring Federal Renewable Energy Credits (F-RECs) to be retired by regulated parties along with the associated WREGIS certificate.** Section 97004 (b) of the draft RES regulation states: **"**RECs must be retired in WREGIS for RES compliance and may not be used to meet the requirements of any federal, state or local program." 3Degrees applauds this language for it is intended to prevent double counting which, in ARB parlance, is a form of emission leakage. However, ARB should consider the potential impact of pending federal RES language and how it could undermine California's renewable and emission reduction goals.

   One potential challenge in the design of a federal RES market is the definition of the new compliance instrument, the federal renewable energy credit (F-REC). The House and Senate RES bills pending in Congress[1] contemplate a dual REC system—in which each unit of energy is the basis for issuing one federal REC in addition to the non-federal REC that is already the standard currency in today's state RES and voluntary markets. The federal REC would be used for compliance with the federal RES, but nothing prevents the other REC, i.e. the non-federal REC, from being used for a variety of purposes, including state RES compliance. As a result, double claims on the same renewable MWh may occur whereby one party claims the F-REC and another party claims the non-federal REC.

   In states with higher RES targets than a federal program, utilities will have more F-RECs than needed for their own federal compliance and could sell their surplus F-RECs to utilities in other states to be used for compliance without creating any additional generation in those states. Many states outside of the WECC lack an RES or have an RES that is lower than the proposed federal standard.

[1] **American Clean Energy and Security Act** (H.R. 2454) and **American Clean Energy Leadership Act** (S. 1462)

Such double counting would amount to GHG emission leakage whereby compliance with California's 33% RES would enable emissions to increase in other states that have no RES in place or that have an RES weaker then the proposed federal standard. Such emission leakage would undermine the emission reduction goals set by AB 32.

Fortunately, both federal RES bills allow state RES programs to exceed the federal RES target. Both bills also give states the authority to regulate F-RECs within their jurisdictions, including requiring that a Federal REC be retired for each non-federal REC used for compliance with a state RES. If states exercise this right then a federal RES will be a floor, but where states allow surplus F-RECs to trade away the federal RES becomes a ceiling.

California should include the following language in the RES Regulation:

"If and when a federal RES becomes effective, regulated parties must demonstrate that they have retired one federal renewable energy credit for each WREGIS REC retired and surrendered for compliance with the California RES."

About 3Degrees

3Degrees, based in San Francisco, is a recognized market leader in renewable energy and climate mitigation products and services. The award-winning firm offers retail and wholesale marketing of Renewable Energy Certificates and Verified Emission Reductions (also known as carbon offsets), climate and energy strategy consulting, marketing and communications services, utility green power program partnership services, and regulatory expertise.

Through these and other partnerships, 3Degrees has supported over 375 high-quality renewable energy and carbon reduction projects in California and throughout the United States. Our commitment to these projects creates jobs and stimulates the low-carbon economy. In addition, in 2009, 3Degrees was named "Renewable Energy Marketer of the Year" by the U.S. Department of Energy for the fourth time in five years.

3Degrees has been working consistently with state, federal and international policymakers on market-based measures to reduce greenhouse gas emissions since its inception in 2002. 3Degrees executed the first transfer on the Gold Standard Foundation's VER registry in 2008. 3Degrees purchased CRTs from the first Climate Action Reserve (CAR) registered project in 2007.

Conclusion

3Degrees greatly appreciates the hard work and leadership that ARB staff has put into the 33% RES draft regulation and overall AB 32 program. We are thankful for the thoughtfulness of the proposal and appreciate the opportunity to contribute comments to the process.

Sincerely,

Gabe Petlin

Gabe Petlin
Director of Regulatory Affairs

Appendix A to follow on next page.

<u>Appendix A</u>
Supporting arguments for why non-regulated parties should be allowed to trade RECs

- **Participation of non-regulated parties increases REC market liquidity while restricting participation would reduce liquidity**
  - A healthy market is "liquid," meaning there is a sufficient number of buyers and sellers in the marketplace to allow trading to take place.
  - Illiquid markets are inefficient, raise compliance costs which in turn raises rate payer costs.
  - A market that is designed with a severely limited number of participants is by definition an illiquid market.
  - A market with less liquidity may be subject to more price volatility and it may be more difficult for entities needing to buy RECs to locate willing sellers.
  - Larger numbers of market participants make it more likely that there will be counterparty (i.e., another party willing to participate in a trade).

- **Participation by non-regulated parties *decreases* the likelihood of RES market manipulation by making control of a significant proportion of RECs by one or a few parties harder.**
  - Non-regulated parties will likely not have the access to the available supply necessary to acquire the market power to manipulate the market.
  - Non-regulated parties, due to their lack of compliance obligations, have the incentive to bring all of their supply of RECs to the market, which facilitates liquidity and makes it more difficult for parties who do not bring their supply to the market to extract an above-market price from buyers.
  - Limiting market participation to regulated parties would exclude beneficial participants, thereby increasing the risk of market manipulation.

- **Restricting market participation will decrease available REC supply**
  - A significant number of RECs that will be generated in the future have already been contracted for in the forward market by non-regulated parties. These RECs would become unavailable for RES compliance, thus decreasing the available supply for RES compliance, thereby increasing the cost of compliance.

- **Restricting participation constrains development of new renewables**
  - Non-regulated parties would have less incentive to buy RECs, leaving developers with fewer available sources of capital (REC buyers) to finance projects.
  - Illiquid markets increase a developer's difficulty in finding buyers, especially for small scale and distributed generation projects.
  - Development becomes more dependent on regulated parties setting the price.

- **Other successful environmental markets do not restrict participation**
  The lesson from other successful environmental markets is that non-restricted participation allows environmental markets to achieve the maximum environmental benefit at a reasonable market-based cost of compliance. Examples include:
  - Cap and trade markets:
    - SOx and NOx

    - California Assembly Bill 32
    - Western Climate Initiative
    - Regional Greenhouse Gas Initiative
- REC markets:
    - Voluntary
    - California RPS (TRECs)
    - Other state RPS markets using RECs