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California Air Resources Board
Attention: Mr. David Mehl
Energy Section Manager
1001 I Street
Sacramento, CA 95814

Dear Mr. Mehl:

RE: Comments on Draft Regulations

San Diego Gas & Electric Company appreciates the opportunity to offer comments and recommendations respecting the Air Resources Board's "RES Preliminary Draft Regulation" (Draft Regulations) dated March 11, 2010. While we support the general direction the draft regulations take, a direction that is consistent with the Board's previous Concept Outline, SDG&E offers specific comments on some areas of concern we have with the Draft Regulations. Our main concerns fall in the following areas –

- The RES should allow for unlimited use of unbundled RECs.
- The RES should permit unlimited trading of RECs
- The RES should be universal and should not provide for arbitrary exceptions
- The RES should not count existing supply that does not meet the current standard
- Renewables acquired under the RES should be eligible to meet other renewable requirements placed on the same procurement entity
- The RES should permit banking and borrowing
- The RES should provide exceptions for events beyond retailers' control
- The RES needs a mechanism for cost management
- The Board should implement any penalties in coordination with other applicable state agencies
- The Draft Regulations are unclear how renewables will count toward AB32 GHG reduction obligations

1. The RES Should Allow For Reasonable Use of Unbundled RECs and Any Limitations Should Apply Equally to All (Section 97004)

The goal of the RES is reduced carbon emissions. The addition of renewable resources, wherever they are located, accomplishes this goal, resulting in less generation from fossil resources. As long as there is proper tracking and accounting, such as through WREGIS, the Board should be indifferent in respect of the location of the renewable resource, or in respect of whether the generation is delivered into California – the impact on global GHG emissions is these same in either case. Accordingly, the

RES program should permit reasonable use of properly accounted-for unbundled RECs. This is consistent with proposed renewable programs in federal legislation.

The CPUC concluded that attaining 33% renewables will require almost a tripling of renewable electricity.¹ The CPUC also recognized that the magnitude of the infrastructure that California will have to plan, permit, procure, develop, and integrate in the next ten years is immense and unprecedented. The infrastructure investment could total as much as \$115 billion in an uncertain financial environment.² Unreasonable restrictions on the use of out-of-state renewable resources may lead to higher costs for transmission infrastructure. A recent study concluded that allowing widespread use of RECs within the WECC may substantially reduce the need for new long-distance transmission, which could reduce the costs of meeting aggressive 33% renewable energy goals.³

SDG&E recognizes that public policy may justify placing some restriction on the total use of unbundled RECs and we have long stated that we could agree to a reasonable limitation. However, any such limitation needs to meet at least two essential criteria: (1) it is placed only on commitments going forward, and is not based on, or constrained by, any past commitments, which were made in good faith based on the rules as they then existed, and (2) the same limitation must apply equally to all load serving entities.

2. The RES Should Permit Unlimited Trading of RECs (Section 97004 (d)(2))

The Draft Regulations also propose that RECs may only be traded by regulated parties who are in compliance with RES obligations (Section 97004 (d)(2)). This is an unworkable requirement that should be deleted. Retailers have an obligation to meet renewables requirements. Whether they choose to trade RECs they may already possess should be a business decision between the seller and the buyer and should not be proscribed by the RES. Allowing such trading will not change the fact that the retailer must still meet the prescribed renewables levels. Moreover, this proposed requirement could be interpreted to substantially reduce the ability to trade RECs at all. Since a retailer is not determined to be in compliance until after a compliance year has ended, based on retail sales and renewables acquisitions that occurred in the compliance year, the retailer could only sell RECs with a year delay. There is no need to intrude into the means by which retailers decide to meet their renewables needs.

3. The RES Should Be Universal and Should Not Use Arbitrary Exceptions as Proposed (Section 97001)

The RES should apply to all retail sellers of electricity. With rules permitting the use of unbundled RECs, this does not create an excessive burden for any retail seller because it does not need to disrupt small retailers' supply portfolio. The Draft Regulations would instead create an artificial threshold of 200,000 MWh of sales per calendar year before any renewables obligation applies (Sections 97001). By establishing this threshold, the Draft Regulations then need to address the situation where a

¹ CPUC, 33% RPS Implementation Analysis Preliminary Results, page 7.

² CPUC, 33% RPS Implementation Analysis Preliminary Results, page 4.

³ Andrew Mills, Amol Phadke, and Ryan Wiser, "Exploration of Resource and Transmission Expansion Decisions in the Western Renewable Energy Zone Initiative," Lawrence Berkeley National Laboratory, February 2010, eetd.lbl.gov/ea/ems/reports/lbnl-3077e-ppt.pdf, page 21.

retailer may be right at the boundary line, hence its proposal for a “partial exemption”. While we understand the purpose of the partial exemption, unfortunately, it turns out to be confusing and difficult to implement. Worse than that, the threshold and partial exemptions invite efforts to evade application of the RES by creating several, smaller retailers, rather than one large one. This is easily accomplished by public agencies through creation of districts, joint powers authorities, or other deliberate means to ensure evading the rule. It is, no doubt, easier yet for direct access providers to limit their size and form several smaller ESPs.

As a result, the Draft Regulations invite bypass efforts that will have the effect of corrupting the retail marketplace. Indeed, retailers can market based on knowing they can evade the cost of maintaining a renewable portfolio. This is a perverse incentive that should not occur under any renewable standard.

The arbitrary limits are unnecessary. The rule can apply to all retailers, with the opportunity for limited exceptions for unique circumstances. Size alone should not be a justification for an exception since retailers of any size are capable of obtaining renewable energy credits. The Staff paper suggests that the reason for the threshold is to address cases where a retailer is already providing 100% hydro power to its customers, or the retailer is “so small that they do not have the staffing and budget to absorb the administrative burden of compliance”. While SDG&E might be willing to acknowledge that there could be unique cases, the Draft Regulations go too far. Any retailer has already had to have sufficient staffing in order to obtain and manage its resource supply. SDG&E misses why those retailers would be unable to obtain necessary RECs to meet its compliance obligation. While we are sensitive to the cost question, every retailer is affected, directly in proportion to size, by the cost and budget impact of the RES. An exception due to budget impact should apply equally to all retailers.

SDG&E has no problem with providing for the potential for exceptions under unique circumstances, but those exceptions should be limited in nature, temporary where possible, and subject to public scrutiny and review to ensure sound policy. Arbitrary size limits should not be the basis for an exception.

4. The RES Should Not Count Existing Supply That Does Not Meet the Current Standard (Section 97004(c))

The Draft Regulations would count toward the RES supply that has never met the State’s definition of an eligible renewable resource, but it would do so only for Publicly Owned Utilities (Section 97002 (a)(15)). For example, the rule would specifically treat large hydro added by Publicly Owned

Utilities as if it were an eligible renewable, even though it never has been. Under the RPS adopted in 2001, hydro above 30 MW did not count toward the compliance obligation. The Draft Regulations would allow Publicly Owned Utilities that ignored the statutory definition of eligible renewables and have, for their own purposes, counted larger hydro projects as if they met a renewable standard, to count those projects toward the RES.

This is inequitable. No retailer should be able to claim that they did not know that large hydro was ineligible for the RPS. There was nothing vague about the definition that would have placed in doubt whether large hydro qualified. This proposal is nothing more than the creation of a special deal for a subset of retailer providers.

We understand that there may be interest among some to enlarge the size of new hydro that could qualify. We take no position on that question of whether the going forward definition should change. Indeed, the Draft Regulations do not propose to increase the size above its current 30 MW for new projects; they only seek to retroactively qualify existing generation that never has been eligible before. This would be no different than if the Draft Regulations proposed to count existing nuclear as meeting the RES, except that counting nuclear might be slightly more egalitarian since its use in the State is more widespread.

5. Renewables Acquired Under the RES Should Be Eligible to Meet Other Requirements for the Same Procurement Entities (Section 97004(b))

The Draft Regulations state that 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.** (Section 97004(b)). By its terms, this language would seem to prevent retailers from counting renewables acquired to meet the RES toward meeting any future federal renewable portfolio standard, federal greenhouse gas requirements, , or even any future California statutory RPS, even though the acquisition is for the very same purpose. This would have multiple perverse effects, including forcing retailers to oppose federal GHG and RPS requirements, something that heretofore SDG&E has supported in principle. Such a result would be unacceptable. If the intent of the requirement is to avoid double-counting with a different state or local jurisdiction’s requirement, then the requirement needs to be more specifically tailored to state the renewables cannot be used to fulfill more than one WECC RPS requirement.

6. The RES Should Permit Banking and Borrowing (Section 97004 (d))

While the Draft Regulations permit some level of banking, it proposes arbitrary limits on banking (Section 97004 (d)). The Draft Regulation does not yet have specific banking language, but it describes the concept as allowing banking of RECs “for up to three years”. If a retail seller has acquired more renewables than were required to meet the RES obligation, then that has created a GHG savings that should be recognized regardless of whether it is a REC or not. Placing a three year limit on that recognition is arbitrary and deters retailers from obtaining resources sooner than is strictly required. This is a counterproductive result, since the Board should be encouraging obtaining more, not fewer, renewables.

The Draft Regulations do not provide at all for the use of “borrowing” or “earmarking”, a concept that recognizes that the timing of additions is never perfect. This concept already exists under the current RPS, and it has worked.

7. The RES Should Create Exceptions for Events Beyond Retailer Control (Section 97008)

The Draft Regulations do not recognize that events could occur that are beyond a retail provider’s control could prevent the retail provider from meeting a renewables target. Development of new generation is subject to an array of uncertainties, including environmental review, obtaining of permits, financing, and availability of needed transmission. Any one or more of these, or other, factors could delay or kill proposed projects on which a retail provider is depending to meet renewables targets. In most, if not all, cases, these kinds of events are wholly outside of the control of the retail provider.

The Draft Regulations do not appear to recognize this fact and would seem to impose an unreasonable outcome of strict liability on retail providers. The Draft Regulations need to make clear that if a retail provider has not been able to achieve a target date due to events outside of its control that would not constitute a violation for which penalties are required. Under such circumstances, it would be reasonable for the Board to require the development of a compliance plan to bring the retail provider back on target and to ensure that the anticipated GHG reductions are achieved.

8. The RES Needs a Clearer Mechanism for Cost Management than That Contained in 97011(b)(7)

The Draft Regulations do not provide a clear mechanism for cost management. Although the Draft Regulations do provide a “Regulation Review” (Section 97011), there is no specific requirement for cost management and no indication that the Regulation Review, the first of which will not be completed until the RES requirements have been in effect for several years, will ensure cost management. The Regulation Review is an important element of the RES, and we fully support these periodic checks. However, they are not adequate alone to ensure that the program does not result in unreasonable costs for electricity ratepayers.⁴

Under an approach that determines whether commitments result in costs that are just and reasonable, the CPUC has an important role. It currently reviews for reasonableness IOU commitments to renewables, so it is logical that the means of cost management should be the CPUC’s determination that the costs are “just and reasonable” in accordance with long-standing regulatory practice. To the extent that the CPUC determines that the costs in the market are not reasonable, the RES should be suspended until conditions change.

Similar rules should apply to POUs, under CEC oversight. As a general principle, the rules for establishing these “just and reasonable” prices should be universally applied through partnership with the CPUC and CEC. There should not be one standard for which the price at which renewables acquisition might be considered “just and reasonable” for IOUs and a different standard for POUs.

The Board has authority to take this action explicitly through AB32, which imposes an affirmative duty on ARB to, “evaluate the total potential costs and total potential economic and noneconomic benefits of the plan for reducing greenhouse gases to California’s economy, environment, and public health, using the best available economic models, emission estimation techniques, and other scientific methods.” (Health and Safety Code section 38561 (d)). Health and Safety Code Section 38562(b)(1) requires that CARB to “Design the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions.” ARB is further directed to consider the cost-effectiveness of its regulations in Section 38562(b)(5) and is required to consider benefits to the economy in Section 38562(b)(6). Accordingly, the Air Resources Board has an affirmative statutory obligation under AB32 to implement an RES in a manner that ensures that cost impacts are minimized and cost effectiveness is maximized.

⁴ The Board should also consider whether other elements of the Regulation Review should have more consideration when the rules are being developed rather than only several years after they have been in effect.

The approach we have proposed above would allow ARB to carry out this obligation, while also implementing the Air Resources Board's obligation to consult with the Public Utilities Commission required in AB32.

9. The Board Should Implement Any Penalties in Section 97008 in Coordination With Other Applicable State Agencies

As we have previously stated, penalties should be reserved for intentional violations, and should not apply if they result from events outside of a retail seller's control. Since IOU procurement is based upon approved procurement plans, in accordance with Public Utilities Code Section 454.5, following an approved plan should create a rebuttable presumption that no intentional violation has occurred. To the extent that non-compliance justifiably requires a penalty, only a single agency should impose the penalty. Since the CPUC is closest to the IOUs' resource planning process, as well as its own decisions to approve or disapprove contracts and proposed renewables projects, SDG&E believes that for IOUs (as well as CCAs and ESPs), a determination of whether penalties should be imposed on IOUs should come from the CPUC, but be enforced by the ARB. For POU and CDWR, we believe that the role of identifying whether penalties are appropriate can be carried out by the CEC, and enforced by the ARB.

10. The Draft Regulations in Section 97005(c) Make it Unclear How Renewables Will Count Toward AB32 Obligations

SDG&E commends the Board for pursuing an RES approach that does not attempt to create winners and losers among different renewables options. However, the draft regulations leave uncertain whether different renewables obtained to meet the RES will count differently in terms of AB32 compliance. Since the RES was intended as a means of meeting AB32 requirements, the uncertainty over treatment of different renewables in counting toward the RES is a significant unanswered question. For example, will all renewables acquired to meet the RES be treated as having zero emissions for purposes of GHG reporting and accounting? If not, then the ARB needs to explain further how it will treat RES-compliant resources so that the issue can be discussed and commented on further. The same is true with how RECs associated with out-of-state power will be accounted for and will impact the GHG cap.

Answers to Specific Questions:

The Board's March 18, 2010 presentation included a series of questions on various issues raised by the Draft Regulations. SDG&E addresses those specific questions below. Details are included in the comments above.

POU Resources:

- Should there be limits on the kinds of "renewable" resources that may be claimed?

SDG&E Comment: For commitments made up to now, the definitions that State law and the CEC have established should apply. Changes to these definitions going forward should be subject to public comment.

- Two utilities have ownership rather than contractual investments; should these investments also be phased out? If so, what approach is recommended?

SDG&E Comment: State law has not proscribed utility ownership so there is no reason to phase it out. However, if it does not follow current definitions of eligible renewables, it should not be counted.

- Should POUs be allowed to use “RES qualifying” resources to meet more than 20% of their RES obligations?

SDG&E Comment: POUs should be required to meet the same definitions applicable to all other retail sellers. They should not have special definitions applicable only to them.

- Should POUs that elected not to claim uncertified resources for the RPS program be allowed to claim them under this provision?

SDG&E Comment: POUs should be required to meet the same definitions applicable to all other retail sellers. They should not have special definitions applicable only to them.

REC Options:

- What are the potential benefits and limitations of the two options?

SDG&E Comment: Consumers benefit from lower cost by maximizing supply alternatives. Conversely, electric customers will likely pay more if options are constrained.

- What development or investment impacts would these two options have on existing or planned in-state renewable resource development and/or transmission development?

SDG&E Comment: Not known.

- Should there be limits on the amount of unbundled and undelivered out-of-state RECs that may be used?

SDG&E Comment: See Section 1 above.

- What are the benefits of electricity delivery requirements?

SDG&E Comment: None. It is an arbitrary requirement that frustrates developing renewables.

Banking and Trading of RECs:

- How long should we allow RECs to be traded?

SDG&E Comment: At any time.

- Should the life of RECs be limited; as proposed the life would be unlimited?

SDG&E Comment: No limit.

- Should REC trading be limited to regulated parties?

SDG&E Comment: No.

- How can we ensure that REC certificates are tracked from cradle to grave?

SDG&E Comment: The WREGIS structure contemplates on-going accounting of renewables.

Small Party Partial Exemption:

- Factors staff is analyzing include significance of load served, administrative burden of compliance, and cost impacts to utilities and ratepayers. What other approaches should we consider to establish the threshold?

SDG&E Comment: Thresholds are arbitrary and require complex rules to deal with straddlers. They are also unnecessary. Exceptions should only be considered on a temporary basis under unique circumstances.

- Should the exemption threshold be tied to a specific year or allowed to float as proposed?

SDG&E Comment: See comment above.

- Would a floating threshold lead to administrative or enforcement difficulties?

SDG&E Comment: Any threshold would be arbitrary, would be subject to gaming, and would be difficult to administer and enforce.

- Are the partial exemption phase-in requirements feasible?

SDG&E Comment: See comment above.

Yours sincerely,



c: Mr. Gary Collord
Mr. Tom Pomales