3Degrees Bringing Climate Solutions Down To Earth

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

Re: 3Degrees Comments on ARB's Renewable Electricity Standard Preliminary Draft Regulation

Dear Ms. Nichols and Mr. Goldstene,

3Degrees appreciates the opportunity to provide comments on the Renewable Electricity Standard (RES) Proposed Regulation Order (PRO), released on June 2, 2010.

We commend the Air Resources Board (ARB) for its recognition that a 33% RES is crucial to achieving the greenhouse gas (GHG) reduction goals under AB 32. Specifically, we support ARB's decision to (a) impose no limits on the use of unbundled renewable energy credits (RECs), (b) allow REC trading by non-regulated parties, (c) prevent double counting of RECs sold into the voluntary market, and (d) include periodic reviews of the RES, especially as it relates to the harmonization and prevention of double counting MWh with a federal RES. These are all components of sensible regulation that achieves GHG reductions in the most cost-effective manner while ensuring the environmental integrity of the RES.

One aspect of the RES that still is a point of concern for 3Degrees, however, is the proposed REC definition in Section 97002(a)(16). The language stating that " [a] REC does not constitute property or a property right," does not comport with over a century of California case law recognizing the property rights in electricity.[1] This proposed language does not accurately reflect the nature of RECs, the present status of various markets for RECs, or their current treatment by other State and Federal agencies. Accordingly, Section 97002(a)(16) as drafted would incur serious unintended consequences upon existing REC markets and REC market participants. Finally, the proposed REC definition does not effectively accomplish the goal of shielding ARB from regulatory takings claims under the 5th Amendment to the United States Constitution,[2] and could be interpreted as a destruction of existing property rights.

3Degrees believes striking any reference to property or property rights in Section 97002(a)(16) would eliminate the ensuing market and regulatory uncertainty that would arise from ARB's refusal to recognize existing property rights in RECs while ensuring that ARB would not be at risk to takings claims should the RES be amended in the future.

[1] See Terrace Water Co. v. San Antonio Light & Power Co., 82 P. 562, 563 (Cal. Dist. Ct. App. 1905).

[2] USCA CONST. Amend. V. (West 2010), see also, Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, (1922).

Property Rights in RECs Already Exist Under California Law

California Civil Code section 654 defines property in terms of ownership: " [t]he ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others. In this Code, the thing of which there may be ownership is called property." [3] It is well established in California that electricity is property capable of being owned and traded.[4] The ability of individuals and businesses to own and use RECs to the exclusion of others, in voluntary markets in California and voluntary and compliance markets in other States, also brings RECs squarely within the understanding of what constitutes property in California. These property rights in RECs exist in addition to the ability of parties to use RECs for compliance with California regulatory requirements.

The California Public Utility Commission (CPUC) has determined that distributed generation (DG) RECs are owned by the generator, acknowledging property rights under California law in DG RECs through the recognition of their exclusive ownership by the party creating them.[5] This ruling by the CPUC further demonstrates that the underlying property rights of RECs exist and can be created, owned, and traded outside of government programs.

Declaring that RECs Do Not Constitute Property or Property Rights Would Incur Unintended Consequences Upon Existing REC Markets and REC Market Participants.

As drafted, Section 97002(a)(16) would create serious market and regulatory uncertainty because the ability of parties to enforce existing and future contractual obligations and pursue remedies would be unclear. Denying the property nature of RECs would also put in jeopardy the ability of investors and lenders to obtain security interests in RECs, and investment in renewable energy could be hurt as a result.

Presently, commentators in California agree that RECs constitute property, although the specific type of property which RECs constitute has not yet been formally determined by the courts.[6] ARB's proposed language would cause creditors to parties owning RECs to reconsider whether they will be able to perfect a security interest in a product which a California regulatory agency has determined is not property. It is possible that creditors would not accept the risk that they may be unable to perfect their security interests, or that creditors would not grant credit on terms as favorable to the debtor. The resulting change in present business practices would make it much more difficult for parties seeking credit to pledge their RECs as collateral.

The proposed language of Section 97002(a)(16) is also inconsistent with the treatment of RECs by the CPUC, the Western Regional Energy Generation Information System (WREGIS), and the United States Environmental Protection Agency (EPA). The EPA website states that a REC

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[3] Cal. Civ. Code § 654, see also, Bady v. Detwiler, 127 Cal. App. 2d 321, (2d. Dist. 1954).

[4] See Terrace Water Co. v. San Antonio Light & Power Co., 82 P. 562, 563 (Cal. Dist. Ct. App. 1905) (" [W]hen one gathers from the elements an energy or force which he may store, transmit, and utilize, he thereby appropriates to his own use that thing, whatever it may be, and it is a subject of ownership, of barter and sale, so long as it is in possession."); see also Baldwin-Lima-Hamilton Corp. v. Super. Ct., 25 Cal. Rptr. 798, 809 (Dist. Ct. App. 1962) (" Electricity is a commodity which, like other goods, can be manufactured, transported and sold").

[5] CPUC Decision 07-01-018 (conclusions of law no. 3).

[6] See RECs In Secured Transactions Under Calif. Law, available at http://www.lw.com/upload/pubContent/_pdf/pub2572_1.pdf.

" represents the property rights to the environmental, social, and other nonpower qualities of renewable electricity generation." [7] Both the definition of a WREGIS Certificate[8] and the CPUC's definition of Green Attributes[9] recognize that RECs may be used for purposes other than compliance. The proposed language in Section 97002(a)(16) would increase regulatory uncertainty surrounding RECs, which could discourage investment in RECs and renewable energy and frustrate the goal of achieving GHG reductions through cost effective means.

Declaring that RECs Do Not Constitute Property or a Property Right Does Not Shield ARB from Regulatory Taking Claims

3Degrees recognizes the concern that acknowledging the property aspects of RECs could expose ARB to claims of a government taking under the 5th Amendment to the United States Constitution. However, Section 97002(a)(16) as drafted would not provide the desired protection and might in-fact increase the ARB's risk to claims of uncompensated takings by negatively affecting existing property rights in RECs.

Historically, emission allowance programs have provided by statute that allowances do not constitute property rights.[10] These provisions ensure that subsequent reductions in allowance allocations will not be subject to 5th Amendment takings claims by affected compliance entities. Emission allowances are entirely created by government programs, and only exist within those confines. RECs are fundamentally unlike emission allowances. RECs are not an allowance or authorization to pollute, are created by the generator of renewable energy, and exist and have value outside of government programs.

The ability to use RECs to meet the requirements of a compliance program is the only aspect of a REC that is a government created right. Subsequent amendments to the RES restricting REC eligibility would not effectuate an uncompensated taking because a party holding formerly eligible RECs would still have the ability use those RECs in voluntary markets and other State and Federal programs. The risk of takings claims is minimal, and ARB would be better protected by not addressing property rights at all in its RES regulations.

As has been established above, property rights in RECs already exist under California Law. Section 97002(a)(16) could be interpreted as eliminating these existing property rights. This elimination of property rights may be a regulatory taking under the 5th Amendment.

ARB Can Mitigate its Regulatory Taking Risk and any Unintended Consequences on Existing REC Markets and REC Market Participants by Amending Section 97002(a)(16)

3Degrees recommends amending Section 97002(a)(16) by striking the sentence " a REC does not constitute property or a property right." This change would bring RES treatment of RECs in line with other State and Federal Agencies, prevent the resulting market and contractual

[7] See http://www.epa.gov/grnpower/gpmarket/rec.htm
[8] WREGIS, Modified WREGIS Certificate Definition
[9] CPUC Decision 08-08-028, Appendix B, page 1.
[10] The Clean Air Act, 42 U.S.C 7651(f)

uncertainty that would arise from a refusal to recognize property rights in RECs, and ensure that ARB does not destroy existing property rights in adopting the RES regulations.

In the alternative, if ARB considers it to be absolutely necessary to state that RECs do not constitute property or a property right, 3Degrees recommends amending Section 97002(a)(16) to read " *The RES compliance value of* a REC does not constitute property or a property right." This change would cause the term to only focus on rights potentially created under AB 32, and would address ARB's concerns regarding regulatory takings.

Conclusion

3Degrees applauds the hard work and thought that ARB staff has put into the 33% RES draft regulation and overall AB 32 program. However, the proposed language of Section 97002(a)(16) would create regulatory and market uncertainty surrounding RECs, possibly hurting investment in renewable energy and the goal of reducing GHG emissions. As shown, valuable property rights in RECs already exist, and the elimination of these rights could be seen as contradicting existing California law and a regulatory taking. By amending this language, ARB can protect itself from takings claims and recognize the existing property rights in RECs, ensuring that investment and demand in renewable energy markets continues to grow.

Thank you for this opportunity to contribute comments.

Sincerely,

Ian McGowan
Manager, Regulatory Affairs
3Degrees