CALIFORNIA LEGISLATURE

STATE CAPITOL
SACRAMENTO, CALIFORNIA
95814

September 20, 2010

Mary Nichols, Chair
Air Resources Board
1001 "I" Street
P.O. Box 2815
Sacramento, CA 95812

RE: Opposition to Air Resources Board Adoption of Renewable Energy Standard

Dear Chair Nichols:

We, the undersigned, are writing to urge the ARB in the strongest terms to set aside its so-called "renewable energy standard" (RES) regulation that is proposed for adoption at your September 23rd board meeting later this week.

The ARB's action is contrary to law, creates economic uncertainty and potential job losses for companies investing in renewable energy here in California, and creates an inefficient and duplicative state bureaucracy during the most severe budget crisis in modern state history.

Contrary to Law and Policy

Our views on this matter are shared by the Legislature's expert lawyers and budget analysts. Both the non-partisan Legislative Counsel's Bureau and the non-partisan Legislative Analyst Office (LAO) formally opined that the Air Board has no authority to adopt its RES regulation and should be barred from implementing it.

On January 11, 2010, the Legislative Counsel Bureau issued a formal legal opinion (attached) stating that the ARB "does not have the authority to implement the California Renewable Energy Electricity Standard [page 20]."

Among other things, the legal opinion notes the law expressly vests other state agencies with renewable energy procurement authority and that AB 32 requires the board to defer to those agencies on matters within their jurisdiction.

In addition, in its Analysis of the 2010-2011 Budget published on March 8, 2010 the LAO similarly opined that the ARB exceeded its authority in proposing an RES (see attachment). The LAO stated that "the Administration is circumventing legislative authority in developing new renewable energy procurement requirements as reflected in current state law, leading to inefficient duplication of efforts by state agencies and wasteful spending."

The LAO further recommended that the Legislature de-fund those positions being used by the Air Board to proceed with RES adoption. That action was taken on a bipartisan, bicameral vote of the Legislative Budget Committees and is now contained in the Budget Conference Committee Report.

Creates New, Duplicative and Inefficient Bureaucracy

In addition to being contrary to law and against explicit legislative direction, the ARB's adoption of an RES undermines the creation of new in-state jobs and economic growth in the renewable energy sector. It creates a potential bureaucratic morass, both for utilities required to build and buy new renewable energy AND for renewable energy companies who want to create jobs in California.

As your board's staff report notes, compliance with the 20% RPS is overseen, and subject to processes and rules established, by the California Public Utilities Commission (CPUC). The RES creates a bizarre and complicated bureaucracy whereby the 20%-33% increment of renewable energy development would be overseen by the ARB, an entirely different agency with an entirely different set of processes and rules than the CPUC.

This approach makes it more difficult—not less—for renewable energy companies to create jobs and do business in California. Instead, it simply sets up another regulatory hurdle for renewable energy development in the state.

Undermines the Board's own economic analysis justifying implementation of AB 32.

As part of its economic justification for AB 32, the board and its outside experts assert that there will be a major increase in jobs created in California due to development of renewable energy. The Board's scoping plan cites a figure of up to 140,000 new job created in the renewable energy sector [Scoping Plan Volume II—Page G 22].

However, the Board's RES allows any renewable energy generated at any time and any place in the west to count towards a utility's compliance with the law. Stated more simply, utilities could comply with the ARB's regulation by building and purchasing 100% of its renewable energy from already existing, out-of-state renewable power plants.

This provides no jobs or economic benefits to California (to say nothing of any putative environmental benefits). It further reinforces the notion that the ARB's economic justification for AB 32 is both flawed and based on assumptions that are not in evidence.

For all of the foregoing reasons, we again strongly urge the board to set aside its RES regulation. This is not the time for the board to be acting in a manner that exceeds its legal authority, creates a costly and duplicative new state bureaucracy, and undermines new jobs and energy development in the state.

Sincerely,

Senate President Pro Tempore

Speaker of the Assembly

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January 11, 2010

Honorable Darrell Steinberg
Room 205, State Capitol

RENEWABLE ENERGY RESOURCES: CALIFORNIA GLOBAL WARMING SOLUTIONS ACT OF 2006: EXECUTIVE ORDER S-21-09 - #0926039

Dear Senator Steinberg:

QUESTION NO. 1

May the Governor, by executive order, require the State Air Resources Board to adopt regulations pursuant to the California Global Warming Solutions Act of 2006 (Div. 25.5 (commencing with Sec. 38500), H.& S.C.) consistent with a 33-percent renewable energy target for all California load-serving entities, and, if so, what constraints exist upon the state board in adopting regulations?

OPINION AND ANALYSIS NO. 1

By way of background, on September 15, 2009, the Governor issued Executive Order No. S-21-09, which states, in pertinent part, as follows:

> "NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER, Governor of the State of California, by virtue of the power vested in me by the Constitution and statutes of the State of California, do hereby order effective immediately as follows:
>
> "1. That the ARB [State Air Resources Board], under its AB 32 [California Global Warming Solutions Act of 2006 (Div. 25.5 (commencing with Sec. 38500), H.& S.C.)] authority, shall adopt a regulation consistent with the 33 percent renewable energy target established in Executive Order

S-14-08 by July 31, 2010.[1] In developing the regulation, the ARB may consider different approaches that would achieve the objectives of the Executive Order and may increase the target and accelerate and expand the time frame based on a thorough assessment of such factors as technical feasibility, system reliability, cost, greenhouse gas emissions, environmental protection or other relevant factors.

"2. That the ARB shall work with the PUC [Public Utilities Commission] and the CEC [State Energy Resources Conservation and Development Commission] to ensure that a regulation adopted under authority of AB 32 to encourage the creation and use of renewable energy sources shall build upon the RPS Program [California Renewables Portfolio Standard Program (Art. 16 (commencing with Sec. 399.11), Ch. 2.3, Pt. 1, Div. 1, P.U.C.)] and shall regulate all California load serving entities, including investor-owned utilities, publically-owned utilities, direct access providers and community choice aggregators.[2]

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[1] Executive Order No. S-14-08, issued November 17, 2008, stated that a "Renewable Portfolio Standard target" was thereby established pursuant to which "[a]ll retail sellers of electricity shall serve 33 percent of their load with renewable energy by 2020" and directed "[s]tate government agencies ... to take all appropriate actions to implement this target in all regulatory proceedings, including siting, permitting, and procurement for renewable energy power plants and transmission lines." Executive Order No. S-14-08 directed the Resources Agency (now, the Natural Resources Agency), State Energy Resources Conservation and Development Commission, and Department of Fish and Game to undertake specific actions (Orders 2 to 15, incl., and 17) and requested the Public Utilities Commission and Independent System Operator to undertake specific actions (Orders 14 and 15). Executive Order No. S-14-08, while mentioning the State Air Resources Board's role as the state agency charged with monitoring and regulating sources of emissions of greenhouse gases (6th WHEREAS clause), did not direct the state board to undertake any action to implement the executive order.

[2] "[I]nvestor-owned utilities" refers to electrical corporations (Sec. 218, P.U.C.). "[P]ublicly-owned utilities" refers to local publicly owned electric utilities (Sec. 224.3, P.U.C.). "[D]irect access providers" refers to electric service providers (Sec. 218.3, P.U.C.). "[C]ommunity choice aggregators" refers to those entities through which customers that are in the distribution area of an electrical corporation are entitled to aggregate their electric loads as members of their local community (Sec. 366.2, P.U.C.). The term "load serving entity" used in Executive Order S-21-09 varies from the term "retail sellers" that was used in Executive Order S-14-08. Both the term "retail seller" and the term "load serving entity" have been defined as including electrical corporations, electric service providers, and community choice aggregators, but excluding local publicly owned electric utilities (subd. (j), Sec. 380, subd. (g), Sec. 399.12, and subd. (e),

(continued...)

"3. That the PUC and the CEC are requested to provide advice and assistance to, and cooperate with, the ARB in its consideration and implementation of a regulation to reduce greenhouse gas emissions through the creation and use of renewable energy sources. The ARB may delegate to the PUC and the CEC any policy development or program implementation responsibilities that would reduce duplication and improve consistency with other energy programs such as demand response, energy efficiency and energy storage.

"4. That the ARB shall consult with the Independent System Operator and other load balancing authorities on, among other aspects, impacts on reliability, renewable integration requirements and interactions with wholesale power markets in carrying out the provisions of this Executive Order.

"5. The ARB shall establish the highest priority for those resources that provide the greatest environmental benefits with the least environmental costs and impacts on public health that can be developed most quickly and that support reliable, efficient, cost-effective electricity system operations including resources and facilities located throughout the Western Interconnection."

Thus, Executive Order No. S-21-09 requires the State Air Resources Board (hereafter the state board) to adopt regulations by July 31, 2010, that are consistent with all load-serving entities serving 33 percent of their load with renewable energy by 2020. The executive order authorizes the state board, in developing regulations, to consider different approaches that would achieve the 33-percent target for renewable energy and to increase the target and accelerate or expand the timeframe for achieving the target based upon a thorough assessment of various factors. The executive order requires the state board to "work with"

(...continued)

Sec. 8340, P.U.C.). Ordinarily, the term "load serving entity" means an entity that serves end users within a control area and has been granted the authority, or has an obligation pursuant to state or local law, regulation, or franchise, to sell electricity to end users located within the control area (Federal Energy Regulatory Commission, Staff Report: Assessment of Demand Response & Advanced Metering (Dec. 2008), Appendix C, p. C-4; see also Energy Information Administration Glossary definition of "load-serving entity (electric)" at www.eia.doe.gov/glossary/glossary_1.htm and 16 U.S.C. Sec. 824q). This definition includes local publicly owned electric utilities. By its terms, Executive Order S-21-09 uses the term "load serving entity" in its usual sense, as including local publicly owned electric utilities, rather than the more limited meaning given the term as defined in Sections 380 and 8340 of the Public Utilities Code. It is unclear if persons or corporations employing cogeneration technology, or producing electricity from other than a conventional power source, which are not electrical corporations (subd. (b), Sec. 218, P.U.C.) or electrical cooperatives (Sec. 2776, P.U.C.), are intended to be included in Executive Order No. S-21-09 as "load serving entities."

the Public Utilities Commission (hereafter the CPUC) and the State Energy Resources Conservation and Development Commission (hereafter the Energy Commission) to ensure that the regulations "build upon the RPS Program" and requests the CPUC and Energy Commission to provide advice and assistance to, and cooperate with, the state board. Outside of directing that the regulations be adopted by July 31, 2010, the executive order provides no information as to what the regulations will do to achieve the 33-percent target for renewable energy, and does not identify the types of electrical generation sources that are renewable energy.

I. Executive Orders

With respect to the authority of a Governor to issue an executive order, the powers of state government are legislative, executive, and judicial. Persons charged with the exercise of one power may not exercise either of the others except as permitted by the Constitution (Sec. 1, Art. IV, Cal. Const.; *Marine Forests Soc. v. California Coastal Com'n* (2005) 36 Cal.4th 1, 44, quoting *Carmel Valley Fire Protection Dist. v. State* (2001) 25 Cal.4th 287, 297). There is no constitutional or statutory provision expressly authorizing the Governor to issue an "executive order." The Governor's authority to issue an executive order derives from the constitutional provisions conferring the supreme executive power on the Governor and requiring the Governor to see that the laws are faithfully executed (Sec. 1, Art. V, Cal. Const.).

As chief executive, the civil administration of the laws of the state is vested in the Governor (Sec. 11150, Gov. C.), and it is the duty of the Governor to supervise the official conduct of all executive and ministerial officers and to see that all offices are filled and their duties performed (Secs. 12010 and 12011, Gov. C.). If default occurs, the Governor is required to apply any remedy that the law allows, and, if the remedy is imperfect, the Governor is required to so advise the Legislature at its next session (Sec. 12011, Gov. C.). It is under this authority that the Governor is authorized to issue an "executive order."

Thus, the Governor may issue executive orders to implement and execute the duties and powers vested in the office of the Governor pursuant to constitutional and statutory provisions. The Governor may also require executive officers and agencies and their employees to furnish information and reports relating to their duties (Sec. 4, Art. V, Cal. Const.; Sec. 11091, Gov. C.). The Governor is authorized to employ personnel to assist him or her in carrying out these executive functions (Sec. 12001, Gov. C.), and the Governor is authorized to utilize the services of other state officers or agencies in carrying out these functions (Secs. 11150 and 11152, Gov. C.). An executive order need not be predicated upon some express statutory provision, but may be properly employed to effectuate a right, duty, or obligation that emanates or may be implied from California law to enforce public policy embodied within the California Constitution or the statutes of the state (*Spear v. Reeves* (1906) 148 Cal. 501, 504-505).

However, there is no statutory or constitutional authority for the Governor to undertake executive action that would have the effect of enacting, enlarging, or limiting legislation (see *Youngstown Sheet & Tube Co. v. Sawyer* (1952) 343 U.S. 579, holding that an

order of the President seizing steel mills, which directed that presidential policy be executed in the manner prescribed by the President, was unconstitutional because it was an attempt to enact law, which is a power restricted to the Congress). In carrying out the statutes enacted by the Legislature, executive officers and authorities must apply or execute the statutes as enacted, and they cannot, by rule or regulation, change or extend their own statutory powers or vary or enlarge the terms of a legislative enactment (*Whitcomb Hotel v. California Employment Commission* (1944) 24 Cal.2d 753, 757; *Physicians & Surgeons Laboratories, Inc. v. Department of Health Services* (1992) 6 Cal.App.4th 968, 982). In addition, because a regulation promulgated by an administrative agency pursuant to its rulemaking powers, and reasonably adapted to the administration of a legislative act, has the force and effect of law (*Dabis v. San Francisco Redevelopment Agency* (1975) 50 Cal.App.3d 704, 706), an executive order also may not contravene a regulation. Thus, as a general proposition, the Governor may not issue an executive order that contravenes either a statute or a regulation.[3]

It is pertinent to the understanding of the scope of the Governor's power to issue executive orders that Section 1 of Article IV of the California Constitution vests the entire legislative power of the state in the Legislature, except for the powers of initiative and referendum reserved to the people and the authority of the Governor to approve or disapprove of legislation (*State Personnel Bd. v. Department of Personnel Admin.* (2005) 37 Cal.4th 512, 523).[4] The essentials of the legislative function are the determination and formulation of legislative policy (*Carmel Valley Fire Protection Dist. v. State*, supra, at p. 299). Pursuant to Section 3 of Article III of the California Constitution, the Governor, as chief of the executive branch of state government (Sec. 1, Art. V, Cal. Const.), would be prohibited from exercising legislative power, except as expressly permitted by the California Constitution. The Legislature may, after declaring a policy and fixing a primary standard, confer upon executive or administrative officers the "power to fill up the details" by prescribing administrative rules and regulations to promote the purposes of the legislation and to carry it into effect (*First Indus. Loan Co. of Cal. v. Daugherty* (1945) 26 Cal.2d 545, 549). However, an attempted delegation of the power to make the law, which necessarily involves

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[3] We do not address in this opinion the authority of the Governor to suspend any regulatory statute, or statute prescribing the procedure for conduct of state business, or the orders, rules, or regulations of any state agency during a state war emergency or state of emergency under the California Emergency Services Act (Ch. 7 (commencing with Sec. 8550), Div. 1, Title 2, Gov. C.).

[4] While engaged in considering bills which have passed both houses of the Legislature and are before him or her for approval or disapproval, the Governor acts in a legislative capacity, and not in an executive capacity (*Lukens v. Nye* (1909) 156 Cal. 498, 501-503). The Governor is forbidden, however, to otherwise exercise any legislative power or function except as enumerated, or necessarily implied, in the California Constitution (Id., at p. 503).

discretion as to what it shall be and conferring authority or discretion as to its execution, is improper (*Carmel Valley Fire Protection Dist. v. State*, supra, at p. 299).

Pursuant to the authority discussed above, the Governor as chief executive may direct state entities within the executive department to take or refrain from taking certain actions that are within the express or implied powers of those entities, but the Governor may not otherwise issue an executive order that conflicts with or enlarges any express or implied authority granted to, or diminishes a duty conferred upon, those entities by statute, or with respect to the CPUC, by statute or the California Constitution.

As discussed above, Executive Order No. S-21-09 requires the state board to adopt regulations by July 31, 2010, that are consistent with all load serving entities serving 33 percent of their load with renewable energy by 2020. The question presented requires that we evaluate whether the executive order only requires the state board to take, or refrain from taking, certain actions that are within the express or implied powers of the state board, or whether the executive order conflicts with, or enlarges upon, any express or implied authority granted to the state board or other state entities.

The CPUC is not an ordinary administrative agency, but a constitutional body with broad legislative and judicial powers (*San Diego Gas & Electric Co. v. Superior Court* (1996) 13 Cal.4th 893, 914-915; *Southern California Edison Co. v. Public Utilities Com'n* (2000) 85 Cal.App.4th 1086, 1096; *Wise v. Pacific Gas & Electric Co.* (1999) 77 Cal.App.4th 287, 300). The CPUC, formerly known as the Railroad Commission, derives certain of its powers by direct grant pursuant to Article XII of the California Constitution[5] and certain powers by statutory grant from the Legislature (*People v. Western Air Lines* (1954) 42 Cal.2d 621, 634). Section 3 of Article XII specifies the classes of "public utilities subject to control by the Legislature" and authorizes the Legislature to prescribe that additional classes of private corporations or other persons are public utilities. Included as public utilities in Section 3 of Article XII are private corporations and persons that own, operate, control, or manage a line, plant, or system for production, generation, transmission, or furnishing power directly or indirectly to or for the public (see also Sec. 218).

The CPUC is granted certain general powers with respect to all public utilities by the California Constitution, subject to control by the Legislature. Section 2 of Article XII authorizes the CPUC to establish its own procedures, "[s]ubject to statute and due process," and authorizes any commissioner designated by the CPUC to take certain actions, subject to CPUC approval. Section 6 of Article XII, among other things, authorizes the CPUC to fix rates and establish rules for all public utilities. In addition to the general powers conferred by Section 2 and Section 6 of Article XII, Section 5 of Article XII provides as follows:

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[5] All section and article references hereafter are to the California Constitution, unless otherwise indicated. Hereafter, all section references, without article or code references, are to the Public Utilities Code.

> "SEC. 5. The Legislature has plenary power, unlimited by the other provisions of this constitution but consistent with this article, to confer additional authority and jurisdiction upon the commission, to establish the manner and scope of review of commission action in a court of record, and to enable it to fix just compensation for utility property taken by eminent domain."

In conferring additional powers upon the CPUC, the Legislature is not limited by restrictions contained in the California Constitution, such as those provisions vesting judicial power in the courts, legislative power in the Legislature, or municipal powers in municipalities (*San Diego Gas & Electric Co. v. Superior Court*, supra, at p. 915). For example, although municipal utilities are not within the definition of public utilities in Section 3 of Article XII, the Legislature may subject municipal utilities to regulation by the CPUC (*County of Inyo v. Public Utilities Com.* (1980) 26 Cal.3d 154, 166-167). The ability of the Legislature to confer additional powers upon the CPUC "unlimited by the other provisions of" the California Constitution, as provided in Section 5 of Article XII, is unique to the CPUC. The Legislature has the power to retroactively furnish the CPUC with missing authority, through a curative or validating act (*Southern Cal. Gas Co. v. Public Utilities Com.* (1985) 38 Cal.3d 64, 67, affirming award of public participation costs made prior to the Legislature's grant of authority to the CPUC). However, this plenary authority to confer additional powers upon the CPUC, unlimited by restrictions contained in the California Constitution, is subject to the limitation that the additional powers bestowed upon the CPUC must be "consistent" with Article XII, which, as construed by the courts, means that the powers must be "cognate and germane to the regulation of public utilities" (*Southern Cal. Gas Co. v. Public Utilities Com.* (1979) 24 Cal.3d 653, 656-657). The reported cases have not elaborated upon what powers are or are not cognate and germane to the CPUC's regulation of public utilities. As the terms are ordinarily used, something is cognate and germane if it is related, or similar (Webster's 3d New Internat. Dict. (2002), pp. 440 and 951). The plenary authority of the Legislature to confer additional authority on the CPUC is also subject to the people's reserved right to legislate through the initiative process (*Independent Energy Producers Ass'n v. McPherson* (2006) 38 Cal.4th 1020, 1043-1044).

Section 8 of Article XII provides, in part, as follows: "A city, county, or other public body may not regulate matters over which the Legislature grants regulatory power to the Commission." Pursuant to Section 8 of Article XII, if the Legislature grants regulatory authority to the CPUC over a matter, a city, county, or other public body may not regulate that matter and the CPUC's jurisdiction is exclusive (see *San Diego Gas & Electric Co. v. City of Carlsbad* (1998) 64 Cal.App.4th 785, 802; *Southern Cal. Gas Co. v. City of Vernon* (1995) 41 Cal.App.4th 209, 215-217). In our view, a court that reaches the question would likely hold that the state board is a public body for purposes of Section 8 of Article XII (*Dorrier v. Dark* (Tenn., 1976) 537 S.W.2d 888, 892; see also Secs. 1101 and 5450, Gov. C.; Sec. 33004, H.& S.C.). Where the CPUC has expressly or impliedly asserted exclusive jurisdiction over certain issues pursuant to its broad statutory powers, the normal rule of preemption is as

applicable to courts as to local agencies (*San Diego Gas & Electric Co. v. Superior Court*, supra, at pp. 943-944, holding that the CPUC had exercised exclusive jurisdiction with respect to powerline electric and magnetic fields hazards, precluding tort personal injury claims). However, the Legislature may confer concurrent jurisdiction over public utilities to other governmental entities (*Orange County Air Pollution Control Dist. v. Public Util. Com.* (1971) 4 Cal.3d 945, 953-954, the Legislature gave air pollution control districts concurrent jurisdiction to approve construction and operation of powerplants; see also *County of Sonoma v. State Energy Resources Conservation etc. Com.* (1985) 40 Cal.3d 361, 370-371).

II. California Renewables Portfolio Standard

The Legislature has enacted the California Renewables Portfolio Standard Program (Art. 16 (commencing with Sec. 399.11), Ch. 2.3, Pt. 1, Div. 1, P.U.C.; hereafter the RPS program), which is primarily enforced by the CPUC, working in association with the Energy Commission.[6] As discussed below, the RPS program establishes a comprehensive system regulating the manner in which "retail sellers" procure eligible renewable energy resources. While the CPUC enforces the RPS program requirements with respect to retail sellers, other statutes place the responsibility upon the governing bodies of local publicly owned electric utilities to adopt a renewables portfolio standard for each utility (Sec. 387, P.U.C.).

The intent of the RPS program is to attain a target of generating 20 percent of total retail sales of electricity in California from eligible renewable energy resources by December 31, 2010 (subd. (a), Sec. 399.11; see also Sec. 25740, P.R.C.).[7] Consistent with this intent, the CPUC is required to implement annual renewables portfolio standard procurement targets for each retail seller, including electrical corporations, electric service providers, and community choice aggregators, but not including local publicly owned electric utilities (subd. (g), Sec. 399.12), which require the retail seller to increase its total

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[6] The RPS program complements the Renewable Energy Resources Program (Ch. 8.6 (commencing with Sec. 25740), Div. 15, P.R.C.) administered by the Energy Commission (subd. (d), Sec. 399.11, P.U.C.).

[7] The definition of an eligible renewable energy resource (subd. (c), Sec. 399.12) incorporates the definition of an in-state renewable electricity generation facility (subd. (b), Sec. 25741, P.R.C.) from the Renewable Energy Resources Program, with additional programmatic limitations (paras. (1) and (2), subd. (c), Sec. 399.12) and expansions (Sec. 399.12.5). The definition of an in-state renewable electricity generation facility requires that the facility use "biomass, solar thermal, photovoltaic, wind, geothermal, fuel cells using renewable fuels, small hydroelectric generation of 30 megawatts or less, digester gas, municipal solid waste conversion, landfill gas, ocean wave, ocean thermal, or tidal current" (para. (1), subd. (b), Sec. 25741, P.R.C.) and that the electricity generated by the facility be "delivered" to an in-state location (subpara. (A), and cl. (iii), subpara. (B), para. (2), subd. (b), Sec. 25741, P.R.C.).

procurement of eligible renewable energy resources by at least an additional 1 percent of retail sales per year so that 20 percent of its retail sales are procured from eligible renewable energy resources no later than December 31, 2010 (para. (1), subd. (b), Sec. 399.15). The CPUC is prohibited from ordering a retail seller to procure more than 20 percent of its retail sales of electricity from eligible renewable energy resources. Paragraph (1) of subdivision (b) of Section 399.15 provides, in pertinent part, as follows:

> "A retail seller with 20 percent of retail sales procured from eligible renewable energy resources in any year shall not be required to increase its procurement of renewable energy resources in the following year."

The CPUC is required to adopt flexible rules for compliance that permit a retail seller to apply excess procurement in one year to the subsequent years or inadequate procurement in one year to no more than the following three years (cl. (i), subpara. (C), para. (2), subd. (a), Sec. 399.14; see also para. (4), subd. (b), Sec. 399.15). The flexible rules for compliance are also required to address situations where, as a result of insufficient transmission, a retail seller is unable to procure eligible renewable energy resources sufficient to satisfy the requirements of the RPS program (cl. (ii), subpara. (C), para. (2), subd. (a), Sec. 399.14). The CPUC is authorized to allow a retail seller to use renewable energy credits, as defined (subd. (f), Sec. 399.12), to satisfy the requirements of the renewables portfolio standard established by the CPUC (subd. (a), Sec. 399.16) and is required to allow an electrical corporation to recover the reasonable costs of purchasing renewable energy credits in rates (subd. (b), Sec. 399.16).

The RPS program requires the CPUC to direct each electrical corporation to prepare a renewable energy procurement plan to satisfy its renewables portfolio standard procurement requirements and, to the extent feasible, that plan is to be proposed, reviewed, and adopted by the CPUC as part of the electrical corporation's general procurement plan (subd. (a), Sec. 399.14).[8] The renewable energy procurement plan, consistent with the goal of procuring the least-cost and best-fit eligible renewable energy resources, is required to

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[8] The reference to the electrical corporation's general procurement plan process refers to the process that requires each electrical corporation to propose, and for the CPUC to approve, a plan for the procurement of electricity for its retail customers that is consistent with its obligation to serve (subd. (a), Sec. 454.5). Among other things, the electrical corporation's plan is required to show that the "electrical corporation will, in order to fulfill its unmet resource needs and in furtherance of Section 701.3, until a 20 percent renewable resources portfolio is achieved, procure renewable energy resources with the goal of ensuring that at least an additional 1 percent per year of the electricity sold by the electrical corporation is generated from renewable energy resources, provided sufficient funds are made available pursuant to Sections 399.6 and 399.15, to cover the above-market costs for new renewable energy resources" (subpara. (A), para. (9), subd. (b), Sec. 454.5).

include: (1) an assessment of annual or multiyear portfolio supplies and demand to determine the optimal mix of eligible renewable energy resources with deliverability characteristics, (2) provisions for employing available compliance flexibility mechanisms established by the CPUC, and (3) a bid solicitation that sets forth the need for eligible renewable energy resources of each deliverability characteristic, required online dates, and locational preferences, if any (para. (3), subd. (a), Sec. 399.14). After the plan is proposed, the CPUC is required to review and accept, modify, or reject the plan prior to the commencement of renewable procurement by the electrical corporation (subd. (c), Sec. 399.14) and to thereafter review the results of the solicitation submitted for approval by an electrical corporation and accept or reject proposed contracts with eligible renewable energy resources based on consistency with the approved plan (subd. (d), Sec. 399.14). If the CPUC determines that the bid prices are elevated due to a lack of effective competition among the bidders, the CPUC is required to direct the electrical corporation to renegotiate the contracts or conduct a new solicitation (Ibid.). Procurement and administrative costs associated with long-term contracts entered into by an electrical corporation for eligible renewable energy resources pursuant to the RPS program and approved by the CPUC are reasonable per se and are required to be recoverable in rates (subd. (g), Sec. 399.14). The RPS program modifies certain requirements for an electrical corporation with 60,000 or fewer customer accounts in California that serves retail end-use customers outside California (Sec. 399.17).

For an electrical corporation, the obligation to procure eligible renewable energy resources is subject to a limit on the total amount of costs expended above a market price determined by the CPUC (subds. (a), (c), and (d), Sec. 399.15). The CPUC refers to this limitation as the "market price referent" (see Resolution E-4118, dated October 4, 2007). The CPUC is required to consult with the Energy Commission when determining the market price referent (subd. (f), Sec. 399.15).

The RPS program requires the Energy Commission to certify those eligible renewable energy resources that meet the criteria in the definition of an eligible renewable energy resource (subd. (a), Sec. 399.13) and to design and implement an accounting system to verify compliance with the RPS program by retail sellers, to ensure that electricity generated by those facilities is counted only once for the purpose of meeting the renewables portfolio standard procurement requirements of this or any other state, to certify renewable energy credits, and to verify retail product claims in this state or any other state (subd. (b), Sec. 399.13). The Energy Commission is required to consult with other western states within the Western Electricity Coordinating Council and to establish a system for tracking and verifying renewable energy credits with respect to retail sellers (subd. (c), Sec. 399.13).

The implementation and enforcement of a renewables portfolio standard for a local publicly owned electric utility are entrusted to the governing body of the utility, and require that the renewables portfolio standard implemented by the governing body recognize the intent of the Legislature to encourage renewable resources while taking into consideration the effect of the standard on rates, reliability, and financial resources and the goal of environmental improvement (subd. (a), Sec. 387). There is no requirement that any

particular percentage of electricity be procured from renewable sources and there is no requirement that the electricity that the utility procures be from sources meeting the definition of an eligible renewable energy resource. Each local publicly owned electric utility is required to report certain information relative to the implementation of its renewables portfolio standard to its customers and the Energy Commission (subd. (b), Sec. 387).

III. The California Global Warming Solutions Act of 2006

The California Global Warming Solutions Act of 2006 (Div. 25.5 (commencing with Sec. 38500), H.& S.C.; hereafter the act), establishes the state board as the state agency responsible for monitoring and regulating greenhouse gas emission sources (Sec. 38510, H.& S.C.). The act requires the state board to adopt regulations to require the reporting and verification of statewide greenhouse gas emissions and to monitor and enforce compliance with this program (Sec. 38530, H.& S.C.). The act requires the state board to adopt a statewide greenhouse gas emissions limit to be achieved by 2020, equivalent to the statewide greenhouse gas emissions levels in 1990 (Pt. 3 (commencing with Sec. 38550), Div. 25.5, H.& S.C.). The state board is required to adopt rules and regulations in an open public process to achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions (Sec. 38560, H.& S.C.). The state board is authorized to include market-based compliance mechanisms to comply with the regulations (Sec. 38570, H.& S.C.).

It was the intent of the Legislature in enacting the act to avoid imposing duplicative or inconsistent regulatory requirements on electricity and natural gas providers (subd. (g), Sec. 38501, H.& S.C.). The act requires the state board to consult with the CPUC and other state agencies and requires that any greenhouse gas emissions reduction activities adopted and implemented be complementary, nonduplicative, and implemented in an efficient and cost-effective manner (subd. (a), Sec. 38561, H.& S.C.). The act specifically requires the state board to consult with the CPUC in the development of the regulations as they affect electricity and natural gas providers in order to minimize duplicative or inconsistent regulatory requirements (subd. (f), Sec. 38562, H.& S.C.).

Passage of the act did not, by implication, repeal the requirements of the RPS program. It is well established that the repeal of statutes by implication is not favored; the Legislature is not presumed to intend repeal of an act by the passage of a subsequent enactment if a fair and reasonable construction can be given to both (*County of Kern v. Pacific Gas & Electric Co.* (1980) 108 Cal.App.3d 418, 425). Here, the act expressly states that: "[n]othing in this division [Div. 25.5 (commencing with Sec. 38500), H.& S.C.] affects the authority of the Public Utilities Commission" (subd. (a), Sec. 38593, H.& S.C.). Thus, while the Legislature has given the state board concurrent jurisdiction over electrical corporations with respect to regulating emissions of greenhouse gases (see *Orange County Air Pollution Control Dist. v. Public Util. Com.*, supra, at pp. 953-954), any measures implemented by the state board are to be consistent with, and not duplicative of, the regulatory authority exercised by the CPUC, and there is no implied repeal or amendment of any regulatory authority of the CPUC, including the RPS program requirements.

Although the act expressly provides that its provisions do not affect the authority of the CPUC, there is an issue of whether the act affects the authority of other state agencies with respect to regulating emissions of greenhouse gases. In this connection, Section 38574 of the Health and Safety Code states as follows:

> "38574. Nothing in this part or Part 4 (commencing with Section 38560) confers any authority on the state board to alter any programs administered by other state agencies for the reduction of greenhouse gas emissions."

Section 38574 of the Health and Safety Code is in Part 5 (commencing with Section 38570) of the act. Part 5 pertains to the state board's authority to adopt market-based compliance mechanisms. Section 38574 of the Health and Safety Code also applies to Part 4 (commencing with Section 38560), which requires the state board to adopt rules and regulations in an open public process to achieve the maximum technologically feasible and cost-effective reductions in emissions of greenhouse gases. Section 38574 of the Health and Safety Code, by its terms, is not applicable to Part 6 (commencing with Section 38580) of the act, which concerns the state board's enforcement authority. Thus, the lack of authority on the part of the state board to alter programs administered by other state agencies for reducing emissions of greenhouse gases does not limit the state board in exercising its enforcement authority with respect to a program administered by another state agency for reducing emissions of greenhouse gases, so long as the enforcement authority is exercised in a manner that is not duplicative or inconsistent with the regulatory authority of the other state agency.

In our view, reducing emissions of greenhouse gases is one of the public health and environmental benefits that the RPS program is intended to attain and the CPUC and the Energy Commission are state agencies as that term is used in Section 38574 of the Health and Safety Code (see Secs. 11000 and 12891, Gov. C. and Sec. 25199.1, H.& S.C.). The term "alter" has been defined as meaning "to cause to become different in some particular characteristic (as measure, dimension, course, arrangement, or inclination) without changing into something else" (Webster's 3d New Internat. Dict. (2002), p. 63). Courts that have construed the term "alter" typically hold that the term has a meaning that is consistent with this definition (*People v. Sassovich* (1866) 29 Cal. 480, 484; *Wagner v. Shapona* (1954) 123 Cal.App.2d 451, 459). Black's Law Dictionary (6th ed. 1990), at page 77, defines "alter" to have the following meaning:

> "To make a change in; to modify; to vary in some degree; to change some of the elements or ingredients or details without substituting an entirely new thing or destroying the identity of the thing affected. To change partially. To change in one or more respects, but without destruction of existence or identity of the thing changed; to increase or diminish."

In our view, Section 38574 of the Health and Safety Code provides that certain provisions of the act do not confer authority upon the state board to exercise its authority to

adopt regulations or market-based compliance mechanisms in a manner that changes or modifies the RPS program. That section would also deny to the state board the authority to change or modify the greenhouse gases emission performance standard for baseload electrical generating resources established by the CPUC for a load-serving entity, as defined, or by the Energy Commission for a local publicly owned electric utility (Ch. 3 (commencing with Sec. 8340), Div. 4.1). However, the state board may invoke its enforcement authority (Pt. 6 (commencing with Sec. 38580), Div. 25.5, H.& S.C.) if done in a manner that is consistent with, and not duplicative of, the requirements of the RPS program and greenhouse gases emission performance standards for baseload electrical generating resources established by the CPUC and Energy Commission.

Any implication that the act was intended to supplant the RPS program is also disproven by the Legislature's enactment of Senate Bill No. 107 (Ch. 464, Stats. 2006; hereafter S.B. 107), which passed the Legislature the same day as the act (Assembly Weekly History (Oct. 27, 2006) at p. 37; Vol. 1, Senate Final History 2005-06 Regular Session, at p. 91). S.B. 107 imposed additional duties upon the CPUC with respect to the RPS program, including accelerating from December 31, 2017, to December 31, 2010, the date by which a retail seller must procure 20 percent of its retail sales of electricity from eligible renewable energy resources. S.B. 107 additionally amended Section 387 to require that a local publicly owned electric utility, in addition to reporting certain information to its customers, report that information to the Energy Commission. When two acts are passed on the same day and relate to the same subject matter, they are to be read together, as if parts of the same act (*People v. Osorio* (2008) 165 Cal.App.4th 603, 617).

Prior to the enactment of S.B. 107, paragraph (1) of subdivision (b) of Section 399.15 prohibited requiring an electrical corporation with 20 percent of its retail sales procured from eligible renewable energy resources in one year to increase its procurement of such resources in the following year. S.B. 107, as it originally passed the Senate, would have deleted this prohibition (S.B. 107, as amended in the Senate, April 19, 2005, p. 44, lines 2 to 5, incl.). The Senate Energy, Utilities and Communications Committee analysis of S.B. 107 dated April 19, 2005, commenting upon this proposed change in the RPS program statutes, notes that the bill "[r]epeals the 20 percent cap for retail sellers, implying the CPUC may require a retail seller to continue buying renewable resources at the rate of one percent per year after the retail seller attains 20 percent." While the bill was before the Assembly, S.B. 107 was amended to reinsert the prohibition into paragraph (1) of subdivision (b) of Section 399.15 and expand its application by making the prohibition applicable to all retail sellers, rather than being limited to electrical corporations (S.B. 107, as amended in the Assembly, August 7, 2006, p. 29, lines 26 to 29, incl.). The Assembly Utilities and Commerce Committee analysis of the bill dated August 7, 2006, notes that the bill, as amended, "[s]tates that a retail seller that has met its 20% renewable obligation in one year shall not be required to increase its renewable energy procurement in the following year." It is appropriate to review the analyses or reports of a bill prepared by legislative committees to which the bill is assigned in determining the intent of the Legislature (*Preston v. State Bd. of Equalization* (2001) 25 Cal.4th 197, 216-218; *Calvillo-Silva v. Home Grocery* (1998) 19 Cal.4th

714, 722-723; *Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 45). Thus, contemporaneous with the Legislature's enactment of the act, the Legislature accelerated the obligations of retail sellers to procure 20 percent of the electricity sold to retail customers from eligible renewable energy resources, prohibited requiring retail sellers that have achieved the 20-percent procurement requirement to procure additional renewable generation in the following year, and expanded the duties of the governing boards of local publicly owned electric utilities to implement and enforce a renewables portfolio standard for the utility.

The following year, the Legislature enacted Senate Bill No. 1036 (Ch. 685, Stats. 2007; hereafter S.B. 1036), which increased the responsibilities of the CPUC relative to procurement of eligible renewable energy resources by retail sellers. In 2009, the Legislature passed Senate Bill No. 14 (hereafter S.B. 14), Assembly Bill No. 64 (hereafter A.B. 64), and Assembly Bill No. 21 (hereafter A.B. 21), which would have substantially revised the RPS program, including (1) extending the period within which retail sellers must procure 20 percent of the electricity sold to retail end-use customers from eligible renewable energy resources from December 31, 2010, to December 31, 2012; (2) requiring that retail sellers procure 25 percent of the electricity sold to retail end-use customers from eligible renewable energy resources by December 31, 2016; (3) requiring that retail sellers procure 33 percent of the electricity sold to retail end-use customers from eligible renewable energy resources by December 31, 2020 (Sec. 3, A.B. 21); (4) requiring the CPUC to authorize the use of renewable energy credits to satisfy the RPS procurement requirements, subject to certain conditions and limitations (Sec. 9, S.B. 14); and (5) recasting the provisions applicable to local publicly owned electric utilities to make them identical to those applicable to retail sellers, except that the responsibility for implementation would remain with the utility's governing board as opposed to the CPUC (Secs. 3 and 12, S.B. 14). The Governor vetoed each of these 2009 bills.

Courts will look to the evolution of a statute when determining legislative intent (*People v. Goodloe* (1995) 37 Cal.App.4th 485, 491; *Service Employees Internat. Union v. City of Redwood City* (1995) 32 Cal.App.4th 53, 61-63; *Quarterman v. Kefauver* (1997) 55 Cal.App.4th 1366, 1373). While mere evidence that the Legislature failed to pass a particular bill is of little value because legislation may fail to pass for an infinite variety of reasons, including that the Legislature could conclude that the matter was already sufficiently addressed by prior statutory enactments (*People v. Baniqued* (2000) 85 Cal.App.4th 13, 28), where a bill passes both houses of the Legislature and is vetoed by the Governor, the Legislature's intent in passing the legislation, including its understanding of the existing state of the law, can be gleaned from its legislative history (*An Independent Home Support Service, Inc. v. Superior Court* (2006) 145 Cal.App.4th 1418, 1433-1434, fn. 4). The Legislature's adoption of subsequent, amending legislation that is ultimately vetoed may be considered as evidence of the Legislature's understanding of the unamended existing statute (*Freedom Newspapers, Inc. v. Orange County Employees Retirement System* (1993) 6 Cal.4th 821, 832-833; *Ochs v. PacifiCare of California* (2004) 115 Cal.App.4th 782, 791; *California Emergency Physicians Medical Group v. PacifiCare of California* (2003) 111 Cal.App.4th 1127, 1133). In contrast, a Governor's veto message, stating his reasons why existing law should not be altered, is not persuasive

legislative history because a veto message cannot supply post hoc evidence of the Legislature's intent when existing law was originally adopted (*Lockheed Information Management Services Co. v. City of Inglewood* (1998) 17 Cal.4th 170, 199). Thus, it is apparent from the evolution of the RPS program statutes that the intent of the Legislature is that the CPUC is primarily responsible for regulating the manner in which retail sellers procure eligible renewable energy resources, with the Energy Commission performing specific assigned functions relative to that regulatory program, and that the governing boards of local publicly owned electric utilities are responsible for implementation and enforcement of a renewables portfolio standard for those utilities.

In conclusion, pursuant to the authority discussed above, the Governor as chief executive may direct state entities within the executive department to take or refrain from taking certain actions that are within the express or implied powers of those entities. Therefore, the Governor may, by executive order, require the State Air Resources Board, which is within the executive branch of state government, to adopt regulations pursuant to the California Global Warming Solutions Act of 2006 (Div. 25.5 (commencing with Sec. 38500), H.& S.C.) that are consistent with a 33-percent renewable energy target for all California load-serving entities. However, because the Governor may not issue an executive order that conflicts with or enlarges any express or implied authority granted to, or diminishes a duty conferred upon, an entity in the executive branch by statute, Executive Order No. S-21-09 does not authorize the state board to adopt regulations that conflict with existing statutes or regulations or authorize the state board to exercise legislative authority. Therefore, in carrying out the Governor's executive order, the state board may not contravene, alter, or supplant the statutory requirements of the California Renewables Portfolio Standard Program (Art. 16 (commencing with Sec. 399.11), Ch. 2.3, Pt. 1, Div. 1), the most significant of which include the following: (1) the prohibition upon requiring a retail seller with 20 percent of retail sales procured from eligible renewable energy resources in any year to increase its procurement in the following year (para. (1), subd. (b), Sec. 399.15); (2) the flexible rules for compliance adopted by the CPUC (subpara. (C), para. (2), subd. (a), Sec. 399.14); (3) the prohibition upon requiring electrical corporations to incur expenses greater than the limit established for costs that are above the market price referent determined by the CPUC (subds. (a), (c), and (d), Sec. 399.15); and (4) the terms of a renewables portfolio standard adopted by the governing board of a local publicly owned electric utility for that utility (Sec. 387).

QUESTION NO. 2

Does the State Air Resources Board have the legal authority to implement the California Renewable Electricity Standard outlined in the "Proposed Concept Outline for the California Renewable Electricity Standard," as distributed at the board's public meeting held on October 30, 2009?

OPINION AND ANALYSIS NO. 2

On October 30, 2009, the State Air Resources Board held a public meeting at which it presented its staff's initial recommendations for, and to assist the state board in their refinement and development of, regulations to implement Executive Order No. S-21-09. Staff's initial recommendations were contained in a document titled "Proposed Concept Outline for the California Renewable Electricity Standard," which document is the state board's notice to the public of its proposed regulatory actions (page 5, footnote 2; hereafter RES or RES proposal). The staff's RES proposal includes the following elements:

1. The RES would apply to electrical corporations, electric service providers, community choice aggregators, electrical cooperatives, and local publicly owned electric utilities, which would collectively be referred to as the "regulated parties" (RES proposal, p. 9).

2. A compliance schedule would be adopted that establishes annual or multiyear interval requirements for procurement, or annual or multiyear requirements for reducing emissions of greenhouse gases, to meet the RES commencing with 2013 (RES proposal, pp. 10-11). The compliance schedule would eventually require all load-serving entities to procure 33 percent of the electricity sold to retail customers from eligible renewable energy resources (RES proposal, Attachment 2, p. 19). Compliance with the RES timeframe and other implementation requirements would apply independently of the RPS program and, presumably, would also apply independently of the renewables portfolio standard adopted for a local publicly owned electric utility by its governing board (Sec. 387; RES proposal, p. 9).

3. Those generating sources that meet the requirements to be "eligible renewable energy resources" (subd. (a), Sec. 399.12) pursuant to the RPS program would be eligible for compliance with the RES, thereby extending those eligibility requirements to local publicly owned electric utilities. However, comments were solicited on the appropriateness of including other technologies and modifying existing RPS program limitations, but eligibility will not be extended to large hydroelectric or nonrenewable generating facilities, such as nuclear facilities (RES proposal, p. 10).

4. Any eligible renewable generating source located in the state or, if located out of the state, that is connected to the Western Electricity Coordinating Council transmission system, would be eligible for the RES. However, comments were solicited on the potential impact of modifying the deliverability requirements for out-of-state renewable generating resources (RES proposal, p. 10).

5. Renewable energy credits (RECs) separately traded from the electricity generated by the eligible renewable generating source would be eligible for the RES, provided the RECs were tracked by the Western Renewable Energy Generation Information System and the regulated party could demonstrate that the RECs were not used towards meeting the requirements of another renewable generation program or program to reduce emissions of greenhouse gases (RES proposal, p. 10).

6. RES compliance would be assessed on the basis of a regulated party's proportion of electricity sales obtained from eligible renewable generating sources or with RECs, although staff is evaluating other options including measuring the reduction in emissions of greenhouse gases resulting from each renewable generating technology (RES proposal, pp. 10-11).

7. Procurement by a regulated party in one year or compliance period that is in excess of the requirements for that year or compliance period could be applied to later years or compliance periods or traded with other regulated parties (RES proposal, pp. 12-13).

8. Regulated parties would be responsible for maintaining appropriate records and documentation and providing requested information necessary to determine RES compliance to the state board, the Energy Commission, or the CPUC (RES proposal, p. 13).

9. The Energy Commission or the CPUC would be responsible to collect information and to provide annual reports to the state board on the status of regulated party compliance with the RES (RES proposal, p. 14).

10. The state board would review the compliance verification documentation supplied by the Energy Commission or the CPUC and take appropriate enforcement action when a regulated party fails to meet its RES compliance obligations, including financial penalties of up to $75,000 per day per intentional violation (RES proposal, p. 14). If the state board finds that a procurement shortfall was due to circumstances beyond the reasonable control of the regulated party, the state board would be authorized to allow up to three years for the shortfall to be remedied (Ibid.). It is unclear if this latter provision is intended to incorporate the flexible rules for compliance adopted by the CPUC (subpara. (C), para. (2), subd. (a), Sec. 399.14, P.U.C.).

In our view, certain aspects of the state board staff's RES proposal would exceed the authority conferred upon the state board by the California Global Warming Solutions Act of 2006. The proposed RES compliance schedule would require retail sellers to procure an increasing percentage of the electricity sold to retail customers from eligible renewable energy resources until a 33-percent procurement level is reached (RES proposal, pp. 10-11, and Attachment 2, p. 19). Application of the proposed RPS compliance schedule to retail sellers would be contrary to the RPS program prohibition upon requiring a retail seller with 20 percent of retail sales procured from eligible renewable energy resources in any year to increase its procurement in the following year (para. (1), subd. (b), Sec. 399.15). In addition, application of the proposed RPS compliance schedule to those retail sellers that are electrical corporations could alter the RPS program prohibition upon requiring electrical corporations to incur expenses greater than the limit established for costs that are above the market price referent determined by the CPUC (subds. (a), (c), and (d), Sec. 399.15). In our view, the California Global Warming Solutions Act of 2006 does not authorize the state board to adopt requirements for the procurement of eligible renewable energy resources that are contrary to, or alter, the RPS program.

Application of the state board staff's proposed RES compliance schedule to a local publicly owned electric utility, by inclusion of those utilities into the list of regulated parties (RES proposal, p. 9), would be contrary to Section 387, which delegates to each utility's

governing board the duty to implement and enforce a renewables portfolio standard for the utility that recognizes the intent of the Legislature to encourage renewable resources, while taking into consideration the effect of the standard on rates, reliability, and financial resources, and the goal of environmental improvement. Thus, the Legislature has placed the duty upon each governing board to determine the percentage of electricity that it procures from renewable sources and to do so in a manner that considers other public purposes. In addition, the governing board is given the discretion to determine what qualifies as a renewable resource for meeting that utility's renewables portfolio standard. The state board staff's proposed compliance schedule would instead require that renewable sources of generation meeting the definition of an eligible renewable energy resource be used to comply with the utility's 33-percent procurement requirement. Thus, application of the proposed RES compliance schedule is contrary to Section 387. In our view, the California Global Warming Solutions Act of 2006 does not authorize the state board to adopt requirements for the procurement of eligible renewable energy resources that are contrary to Section 387.

The other provisions in the "Proposed Concept Outline for the California Renewable Electricity Standard" include steps to be undertaken by the state board to implement the RES compliance schedule for regulated parties, and, we think, would be contrary to or alter the RPS program. In addition, in our view, the state board lacks the authority to either require or authorize the Energy Commission or the CPUC to be responsible for collecting information and providing annual reports to the state board on the status of regulated party compliance with the RES as proposed by the staff (RES proposal, p. 14). The state board may not authorize another state entity to undertake action that the entity is not otherwise authorized to undertake. The respective responsibilities of the Energy Commission and the CPUC with respect to procurement of eligible renewable energy resources by retail sellers and local publicly owned electric utilities are set forth in the RPS program statutes, with the Energy Commission having additional responsibilities with respect to certain funds pursuant to the renewable energy resources program (Ch. 8.6 (commencing with Sec. 25740), Div. 15, P.R.C.). While the state board is required to consult with the Energy Commission and the CPUC in order to minimize duplicative or inconsistent regulatory requirements (subd. (f), Sec. 38562, H.& S.C.), we find nothing in the California Global Warming Solutions Act of 2006 that provides the state board with authority to require the Energy Commission or the CPUC to assist in enforcement of regulations adopted by the state board, even assuming that the state board has the authority to adopt those regulations.

The state board staff's conceptual alternative to an RES compliance schedule, to adopt annual or multiyear requirements for reducing emissions of greenhouse gases that would be applicable to regulated parties, is not sufficiently developed to enable us to opine as to whether the state board has the authority to adopt those requirements. Presumably, it would be within the authority conferred upon the state board by the California Global Warming Solutions Act of 2006 to adoption limits for emissions of greenhouse gases, which a load-serving entity could meet by increasing its procurement of electricity from renewable generating sources. However, limits for emissions of greenhouse gases and compliance

options to meet those limits can take many forms, and we are unable to opine as to whether the state board may adopt regulations establishing limitations on emissions of greenhouse gases by regulated parties without a proposal that more fully explains how those requirements would be implemented.

The "Proposed Concept Outline for the California Renewable Electricity Standard" takes an expansive view of the state board's authority, taking the position that the California Global Warming Solutions Act of 2006 provides the state board "with broad authority to adopt greenhouse gas emission reduction measures that achieve technologically feasible and cost-effective reductions" in emissions of greenhouse gases (RES proposal, p. 6). In determining whether that expansive view of the state board's authority is correct or, even if correct, whether that gives the state board the authority to adopt the RES proposal, we are guided by the canons of statutory construction. The primary task of statutory interpretation is to ascertain the legislative intent so as to effectuate the purpose of the law consistent with the language of the statute (*In re Marriage of Bonds* (2000) 24 Cal.4th 1, 15; *Hsu v. Abbara* (1995) 9 Cal.4th 863, 871). Even though a court will give great weight to an agency's view of a statute, the reviewing court construes statutes as a matter of law and will reject administrative interpretations where they are contrary to statutory intent (*Messenger Courier Ass'n of Americas v. California Unemployment Ins. Appeals Bd.* (2009) 175 Cal.App.4th 1074, 1086).

Statutory interpretation involves a three-step analysis (*Herman v. Los Angeles County Metropolitan Transportation Authority* (1999) 71 Cal.App.4th 819, 825). First the court examines the actual language of the statute. Because statutory language generally provides the most reliable indicator of legislative intent, a court will first turn to the words of the statute and, where there is no ambiguity in the language, the plain meaning of the statute governs. If the meaning of the words is not clear, the court must take the second step and refer to the legislative history or other extrinsic materials to ascertain the legislative intent (Id., at p. 826). The final step, which should be taken only when the first two steps have failed to reveal clear meaning, is to apply reason, practicality, and common sense to the language at hand, in an attempt to make the statute workable and reasonable (Id., at p. 826).

In our view, the interpretation by the state board staff of the board's authority pursuant to the California Global Warming Solutions Act of 2006 is precluded by the express limitation upon its authority found in Section 38574 of the Health and Safety Code. As discussed above, that section provides that the state board's authority to adopt regulations and market-based compliance mechanisms pursuant to the act does not confer any authority to alter any programs administered by other state agencies for the reduction of emissions of greenhouse gases. Reducing emissions of greenhouse gases is one of the public health and environmental benefits that the RPS program is intended to attain (subds. (a) and (b), Sec. 399.11). The CPUC and the Energy Commission are state agencies as that term is used in Section 38574 of the Health and Safety Code (see Sec. 11000 and 12891, Gov. C. and Sec. 25199.1, H.& S.C.). Therefore, in our view, for the state board to require retail sellers to procure 33 percent of the electricity that they sell to retail end-use customers from eligible

renewable energy resources is an alteration of the requirements of the RPS program and contrary to Section 38574 of the Health and Safety Code.

Furthermore, if a court were to conclude that there is an express statutory conflict between the RPS program statutes and the California Global Warming Solutions Act of 2006 that cannot be resolved by statutory construction, ordinarily a court would resolve that conflict by holding that the RPS program statutes, as the statutes that are specific with respect to the obligations of certain load-serving entities to procure electricity from renewable sources, control over the more general statutes authorizing the state board to undertake actions to reduce emissions of greenhouse gases. A specific statute on a subject controls over a general provision (*Platzer v. Mammoth Mountain Ski Area* (2002) 104 Cal.App.4th 1253, 1260). A specific statutory provision on a particular subject controls over general statutory provisions on the same subject, and a statute of general application will not ordinarily be held to repeal by implication a former statute of special or limited application (*Division of Labor Law Enforcement v. Moroney* (1946) 28 Cal.2d 344, 346; *Department of Indus. Relations v. Lee* (1999) 73 Cal.App.4th 763, 766).

In conclusion, in our view the State Air Resources Board does not have the legal authority to implement the California Renewable Electricity Standard compliance schedule outlined in the "Proposed Concept Outline for the California Renewable Electricity Standard." Moreover, the conceptual alternative to a compliance schedule, to adopt annual or multiyear requirements for reducing emissions of greenhouse gases that would be applicable to regulated parties, is not sufficiently developed to enable us to opine as to the state board's authority. In our view, implementation and enforcement of the compliance schedule would alter, contravene, or supplant the statutory requirements of the California Renewables Portfolio Standard Program (Art. 16 (commencing with Sec. 399.11), Ch. 2.3, Pt. 1, Div. 1), specifically: (1) the prohibition upon requiring a retail seller with 20 percent of retail sales procured from eligible renewable energy resources in any year to increase its procurement in the following year (para. (1), subd. (b), Sec. 399.15); (2) the prohibition upon requiring electrical corporations to incur expenses greater than the limit established for costs that are above the market price referent determined by the CPUC (subds. (a), (c), and (d),

Sec. 399.15); and (3) the terms of a renewables portfolio standard adopted by the governing board of a local publicly owned electric utility for that utility (Sec. 387).

Very truly yours,

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March 8, 2010

The 2010-11 Budget:

Resources and Environmental Protection

CONTENTS

EXECUTIVE SUMMARY

The Governor's budget proposes $6.7 billion from the General Fund, various special funds, and bond funds for resources and environmental protection programs in the budget year. The primary budget-balancing solutions involve new revenue sources to replace General Fund support for (1) state parks and (2) wildland fire protection and emergency response. New spending proposals include ones to modify the funding of recreational uses of the State Water Project (SWP) and to implement the legislative water package enacted last November.

Water Issues

Implementation of the New Legislative Water Package. The Governor's budget proposes a total of $118 million to implement the November 2009 package of water-related legislation. We recommend that: (1) the Two-Gates Project be put on hold, due to uncertainty about whether the federal government will share in its cost, (2) certain contract expenditures for the Delta Stewardship Council be denied because the work is better handled by council staff, and (3) the council be directed to develop a comprehensive long-term financing plan to implement the Delta Plan.

Davis-Dolwig Act Still Requires Major Reform. The Governor's budget proposes $23 million for recreation and fish and wildlife enhancements in SWP under the terms of the Davis-Dolwig Act that governs this aspect of SWP. The administration also proposes statutory changes to this law. The budget request should be denied because the proposed expenditures would result in few recreation or fish and wildlife benefits. We also recommend an alternative to the Governor's budget proposal that would institute fundamental reform of this 48-year-old law to ensure proper legislative oversight of these expenditures.

Proposed Flood Emergency Fund Is Problematic. We recommend rejection of the budget's proposal to create a permanent emergency fund for flood emergencies in the Department of Water Resources. In addition to finding that the proposal has not been justified, we are concerned about the lack of fiscal controls and basic expenditure criteria for accessing the proposed fund. We also find that the proposal would undermine legislative oversight of the department's expenditures.

Energy Issues

Administration Energy Requirements Circumvent Legislative Authority. The administration is currently spending state funds, and proposing further such expenditures, to develop new renewable energy procurement requirements that circumvent legislative policy as reflected in state law—the renewables portfolio standard (RPS). Such spending activity by the administration is premature until and unless the Legislature authorizes it by adopting a new RPS statute. We recommend that the Legislature take action to end such spending, which has led to inefficient duplication of efforts by state agencies and a waste of state resources.

Fee Structure for Power Plant Siting Program Needs Revision. Currently, the Energy Commission's program that issues and enforces permits for large power plants in the state (the siting program) receives the bulk of its funding from the state's electricity ratepayers, with only a small amount of its funding derived from fees levied on power plant developers and operators. We recommend that the current fee structure be revised so as to reduce the disproportionate cost burden imposed by the program on the state's electricity ratepayers and shift more of these costs to power plant developers and operators. Fee revisions are also necessary to address current backlogs in the program which have resulted in permitting delays.

CalFire Issues

Emergency Response Tax Plan and Our Alternative Fee Proposal. We recommend rejection of the Governor's proposal to levy a new surcharge on all property insurance policies to support emergency response activities, largely those relating to wildland fire protection. As an alternative to the Governor's proposed surcharge—which would be a tax—we offer what we consider to be a true fee to partially support the costs of the Department of Forestry and Fire Protection's (CalFire's) wildland fire protection activities. Our recommended fee—levied on property owners with structures in "State Responsibility Areas"—is intended to link a charge more clearly and directly to the defined, identifiable group of property owners that benefit from CalFire's wildland fire protection.

Current Emergency Fund Budgeting Practice at Odds With Original Legislative Intent. The CalFire has access to an Emergency Fund (commonly referred to as the E-Fund) that was intended originally to pay for large-incident firefighting costs. We are concerned about the expanded use over time of the E-Fund by the department—in particular, its practice of charging day-to-day operating costs not related directly to a large incident to the fund. We make recommendations to establish stronger fiscal controls on the use of the E-Fund so as to improve legislative oversight of the department's expenditures.

Other Issues

Tranquillon Ridge Project Warrants Legislative Authorization. We recommend that the Legislature enact legislation to authorize the Tranquillon Ridge project—a 14-year lease for the extraction of oil and gas in state waters off the Santa Barbara coast. In coming to this recommendation, we weigh the policy and fiscal tradeoffs of approving the project. We do, however, recommend rejection of the Governor's proposal to dedicate the ongoing Tranquillon Ridge revenues to support state parks, believing that the Legislature should shy away from unnecessary actions that would lock up these revenues for specific programs.

General Obligation Bond Spending Proposals Warrant Extra Scrutiny. In a resource-constrained fiscal environment, it is possible that the state may not have sufficient access to fully support all of the bond expenditures contemplated in the budget. As a result, we recommend that the Legislature provide direction to the administration on its highest priorities to receive funding from the resources bond appropriations that it approves.

BACKGROUND

Governor's Spending Proposal

Total Spending Down by 38 Percent. Expenditures for resources and environmental protection programs from the General Fund, various special funds, and bond funds are proposed to total $6.7 billion in 2010-11, which is 5.6 percent of all state-funded expenditures proposed for the budget year. This level is a decrease of $4 billion, or 38 percent, below estimated expenditures for the current year. The proposed net reduction is mostly from bond funds. Specifically, the budget proposes bond expenditures totaling about $1 billion in 2010-11—a decrease of $4.2 billion, or 80 percent, below estimated bond expenditures in the current year.

The budget also includes a net reduction of $134 million (7 percent) in General Fund spending, reflecting both proposed spending decreases and increases. The spending decreases reflect a combination of program expenditure reductions and funding shifts to alternative new revenue sources. The budget includes a reduction of $33 million for emergency fire suppression, reflecting an estimate that a lower level of resources will be needed in the budget year following a high level of spending on firefighting activities in the current year significantly beyond the amounts initially budgeted. Still, even with this decrease, the $223 million from the General Fund proposed for emergency fire suppression in 2010-11 is the largest amount ever initially proposed in the Governor's budget plan. This amount is based on the most recent five-year average of these costs. In addition, the budget reflects two major funding shifts in the resources area for the budget year: (1) the replacement of $140 million General Fund support in the Department of Parks and Recreation (DPR) with new revenues from the proposed Tranquillon Ridge oil and gas lease agreement and (2) the replacement of $200 million General Fund support in the Department of Forestry and Fire Protection (CalFire) with new revenues from a proposed surcharge on property insurance premiums statewide.

The budget proposes increased General Fund spending as follows: (1) an additional $201 million to pay for resources-related bond debt-service costs, an increase of 28 percent above estimated current-year expenditures for this purpose; and (2) $30 million to restore General Fund expenditures in the Department of Fish and Game (DFG) that were shifted on a one-time basis to a special fund in the current year. Although not reflected in the resources spending totals, the budget also reflects the administration's intent to make a $98 million partial repayment of a loan made from the Beverage Container Recycling Fund to the General Fund in a prior year.

Multiple Funding Sources; Special Funds Predominate. In contrast to the current year where bond funding predominates, the largest proportion of state funding for resources and environmental protection programs in the budget year—about $3.8 billion (or 57 percent)—would come from various special funds. These special funds include the Environmental License Plate Fund, the Fish and Game Preservation Fund, funds generated by beverage container recycling deposits and fees, an "insurance fund" for the cleanup of leaking underground storage tanks, and a relatively new electronic waste recycling fee. Of the remaining expenditures, $1.8 billion would come from the General Fund (27 percent of total expenditures) and $1 billion from bond funds (16 percent of total expenditures).

Summary of Resource Spending Proposals. Figure 1 shows spending for major *resources* programs—that is, those programs generally within the jurisdiction of the Natural Resources Agency. As the figure shows, the General Fund provides a significant amount of the funding for a number of resources departments. We discuss the extent to which the General Fund is used to support particular resources (as well as environmental protection) programs in greater depth later in this analysis. The year-over-year changes in General Fund spending mostly reflect funding shifts (both replacing and re-

Figure 1

Selected Funding Sources Resources Budget Summary

(Dollars in Millions)

Department	Actual 2008-09	Estimated 2009-10	Proposed 2010-11	Change From 2009-10 Amount	Change From 2009-10 Percent
Resources Recycling and Recovery[a]					
Beverage container recycling funds	—	$625.9	$1,201.6	$575.7	92.0%
Other funds	—	102.6	202.3	99.7	97.2
Totals	**—**	**$728.5**	**$1,403.9**	**$675.4**	**92.7%**
Forestry and Fire Protection (CalFire)					
General Fund	$825.3	$807.7	$554.1	-$253.6	-31.4%
Other funds	534.0	341.6	1,342.3	1,000.7	292.9
Totals	**$1,359.3**	**$1,149.3**	**$1,896.4**	**$747.1**	**65.0%**
Fish and Game					
General Fund	$82.7	$37.4	$68.9	$31.5	84.2%
Fish and Game Fund	77.6	123.1	106.6	-16.5	-13.4
Bond funds	44.4	91.4	27.0	-64.4	-70.5
Other funds	128.3	160.6	185.1	24.5	15.3
Totals	**$333.0**	**$412.5**	**$387.6**	**-$24.9**	**-6.0%**
Parks and Recreation					
General Fund	$135.2	$123.1	—	$123.1	-100.0%
Parks and Recreation Fund	111.6	125.7	$266.3	140.6	111.9
Bond funds	44.9	452.4	91.0	-361.4	-79.9
Other funds	99.2	278.3	222.2	-56.1	-20.2
Totals	**$390.9**	**$979.5**	**$579.5**	**-$400.0**	**-40.8%**
Water Resources					
General Fund	$133.2	$107.7	$110.1	$2.4	2.2%
State Water Project funds	1,396.4	1,568.7	2,043.8	475.1	30.3
Bond funds	645.4	2,549.8	482.4	-2,067.4	-81.1
Electric Power Fund	4,953.3	4,064.6	3,688.8	-375.8	-9.3
Other funds	38.4	135.4	98.5	-36.9	-27.3
Totals	**$7,166.8**	**$8,426.2**	**$6,423.6**	**-$2,002.6**	**-23.8%**
Delta Stewardship					
Bond funds	—	—	$9.7	—	—
Other funds	—	—	39.4	—	—
Totals	**—**	**—**	**$49.1**	**—**	**—**

[a] New department effective January 1, 2010.

storing General Fund support), rather than changes in the level of program expenditures.

While the budget proposes a net reduction in bond spending, it nonetheless reflects a number of new proposals to spend bond funds. These include a proposal to spend $321 million in bond funds (from Propositions 13, 84, and 1E) for flood control projects and levee improvements in the state's Delta and Central Valley regions. The budget also proposes $49 million in bond funds (from Propositions 84 and 50) for groundwater monitoring, water conservation, and other activities implementing the package of Delta/water-related legislation approved by the Legislature in November 2009. Finally, the budget proposes $23 million (mainly bond funds, but also including special funds) for recreation and fish and wildlife enhancements at State Water Project (SWP) facilities, and proposes reform of related statutes, including the Davis-Dolwig Act enacted in 1961. (We provide an update on the bond resources available for resources and environmental protection programs later in the *Resources Bond Issues* write-up later in this analysis.)

Summary of Environmental Protection Spending Proposals. Similar to Figure 1, Figure 2 (see next page) shows spending and fund source information for major *environmental protection* programs—those programs within the jurisdiction of the California Environmental Protection Agency (Cal-EPA). As Figure 2 shows, the budget proposes a few major spending changes in these programs. Most of the 30 percent reduction for the Air Resources Board (ARB) reflects an anticipated decrease in spending from the Proposition 1B transportation bond for air quality improvements in the state's major trade corridors. The 10 percent net increase for the State Water Resources Control Board (SWRCB) reflects both a reduction of $98 million in bond-funded local assistance and an increase of $158 million in spending from the Underground Storage Tank Cleanup Fund to pay more claims seeking reimbursement from the fund for costs to clean up leaking tanks. The latter change results from the enactment of Chapter 649, Statutes of 2009 (AB 1188, Ruskin), that temporarily increased the level of the fee that supports the fund.

Governor's Proposed Budget-Balancing Solutions

Largest Budget Solutions Involve New Alternative Revenue Sources. The primary budget-balancing solutions proposed by the Governor in the resources area involve new revenue sources to replace General Fund support for (1) state parks and (2) wildland fire protection and emergency response.

Regarding funding for state parks, the Governor proposes to use $140 million of Tranquillon Ridge oil and gas lease revenues for this purpose in the budget year. In subsequent years, the Governor proposes that these lease revenues be used for the support of state parks.

Regarding funding for wildland fire protection and emergency response, the budget proposes the Governor's Emergency Response Initiative (ERI), to be implemented together by CalFire, the California Emergency Management Agency (CalEMA), and the Military Department. The ERI is intended to enhance the state's emergency response capabilities, and would be funded by a 4.8 percent surcharge on all residential and commercial property insurance premiums statewide. The budget proposes that ERI special fund revenues in 2010-11 be used to offset $200 million of the department's General Fund

support for wildland fire protection. In subsequent years, ERI revenues would be used both to create General Fund savings and expand emergency response programs in CalFire and other departments. The General Fund savings in subsequent years—estimated around $219 million—result from ERI revenues being used to replace General Fund support for CalFire's Emergency Fund and CalEMA's assistance to local governments.

Other Funding Shifts. The budget proposes to shift $6.4 million of funding for various water quality and water rights regulatory programs from the General Fund to existing fee-based funding sources.

Program Reductions. The budget proposes only a few program reductions as budget-balancing solutions. These include a reduction of $5 million from the General Fund for recreational hunting and fishing programs in DFG.

Figure 2

Selected Funding Sources Environmental Protection Budget Summary

(Dollars in Millions)

Department/Board	Actual 2008-09	Estimated 2009-10	Proposed 2010-11	Change From 2009-10 Amount	Change From 2009-10 Percent
Air Resources Board					
Motor Vehicle Account	$113.7	$113.1	$118.2	$5.1	4.5%
Air Pollution Control Fund	142.4	163.6	171.3	7.7	4.7
Bond funds	3.4	501.0	229.6	-271.4	-54.2
Other funds	65.8	82.7	82.8	0.1	0.1
Totals	**$325.3**	**$860.4**	**$601.9**	**-$258.5**	**-30.0%**
Pesticide Regulation					
Pesticide Regulation Fund	$67.6	$65.8	$71.0	$5.2	7.9%
Other funds	2.7	3.5	8.1	4.6	131.4
Totals	**$70.3**	**$69.3**	**$79.1**	**$9.8**	**14.1%**
Water Resources Control Board					
General Fund	$38.3	$36.7	$34.3	-$2.4	-6.5%
Underground Tank Cleanup	166.2	233.1	396.1	163.0	69.9
Bond funds	72.3	159.8	65.1	-94.7	-59.3
Waste Discharge Fund	80.6	76.2	84.4	8.2	10.8
Other funds	41.5	242.4	245.7	3.3	1.4
Totals	**$398.9**	**$748.2**	**$825.6**	**$77.4**	**10.3%**
Toxic Substances Control					
General Fund	$22.2	$22.7	$23.7	$1.0	4.4%
Hazardous Waste Control	50.4	47.0	49.9	2.9	6.2
Toxic Substances Control	42.5	49.9	57.3	7.4	14.8
Other funds	65.2	66.8	68.4	1.6	2.4
Totals	**$180.3**	**$186.4**	**$199.3**	**$12.9**	**6.9%**
Environmental Health Hazard Assessment					
General Fund	$7.1	$2.2	$2.4	$0.2	9.1%
Other funds	8.1	15.5	17.2	1.7	11.0
Totals	**$15.2**	**$17.7**	**$19.6**	**$1.9**	**10.7%**

Governor's Proposed Reorganizations And Program Reforms

Continuing the Reorganization of the State's Recycling and Waste Management Functions. The budget reflects the implementation of Chapter 21, Statutes 2009 (SB 63, Strickland), that combines the functions of the California Integrated Waste Management Board and the Department of Conservation's Division of Recycling to create the Department of Resources Recycling and Recovery in the Natural Resources Agency as of January 1, 2010. The administration notes that the location of all of the state's waste management and recycling functions currently in the Natural Resources Agency may not be the appropriate one for each of these functions. Given this, the administration has stated its intent to pursue further changes to the reorganization of these functions. Details of the administration's proposal were not yet available at the time this analysis was prepared.

Beverage Container Recycling Program Changes. In conjunction with the budget, the Governor has submitted a legislative proposal to implement various programmatic and budgetary changes in the beverage container recycling program. Some of these changes are proposed to take effect several years from now, such as a proposal to incorporate the cost of recycling into the price paid by consumers for beverage containers. Other changes, such as the proposed elimination of several recycling programs and subsidies that the administration contends are unnecessary, would take effect beginning in the budget year.

The Role of General Fund in Resources and Environmental Protection Programs

Where Does the $1.8 Billion Go? As mentioned above, the budget proposes about $1.8 billion from the General Fund for resources and environmental protection purposes, including for general obligation bond debt service. Over the last decade, the level of General Fund support for these purposes has been highly variable—reaching a peak of about $2.6 billion in 2000-01 (when the state's General Fund condition was particularly healthy), and a low point of about $1 billion in 2003-04.

Debt Service a Major Driver of Resources-Related General Fund Expenditures. Figure 3 (see next page) shows the departments that are recipients of General Fund monies in the resources and environmental protection area, and the corresponding percentage of their budgets that are funded from the General Fund. As shown in the figure, the General Fund expenditure for resources-related general obligation debt service accounts for $929 million (52 percent) of the $1.8 billion. Expenditures for debt service have increased exponentially over the last decade, reflecting voter approval of several, increasingly larger bond measures. Accordingly, outside of debt service, $871 million of the $1.8 billion from the General Fund directly supports program budgets.

$871 Million General Fund Proposed for Programs Largely Reflects Fire Protection Costs. As shown in Figure 3, the largest General Fund programmatic expenditure by far in the resources area is for CalFire. The General Fund supports CalFire's (1) core fire protection program ($523 million), (2) the forest resource management program ($28 million, of which about $11 million is for timber harvest plan review),

and (3) the Office of the State Fire Marshal ($3 million). While the General Fund supports 29 percent of the department's total budget, it supports about 70 percent of its state operations (that is, excluding capital outlay).

The General Fund budget proposed for CalFire for 2010-11 would total $754 million if not for the proposed $200 million funding shift to ERI revenues—a total amount that is substantially higher than the expenditure level a decade ago. Without the proposed funding shift, General Fund expenditures would be 75 percent ($323 million) higher than in 2000-01. There are a number of factors that have driven the department's fire protection costs upwards so significantly, including increasing labor costs, the growing population in and around wildland areas, and unhealthy forest conditions (particularly in Southern California).

General Fund Support Has Dropped in Other Areas. Apart from its support for fire protection, the General Fund generally supports resources and environmental protection programs at levels that are lower than in 2000-01. For example, from a 2000-01 peak, General Fund support for the Department of Water Resources (DWR) and SWRCB has declined by 74 percent and 66 percent, respectively. For the most part, these declines in General Fund support are not reflected in reduced program levels. Rather, for resources departments, these declines have been largely offset by newly available bond funds and in some cases by revenues from increased fees

Figure 3

Governor's Proposed General Fund Expenditures—Resources and Environmental Protection

(Dollars in Millions)

	General Fund Amount	As Percentage of Total Departmental Budget
Departmental Budgets		
CalFire	$554.1	29%
Department of Water Resources	110.1	4[a]
Fish and Game	68.9	18
California Conservation Corps	38.0	39
State Water Resources Control	34.3	4
Toxic Substances Control	23.7	12
Coastal Commission	11.2	62
State Lands Commission	9.3	31
Delta Stewardship Council	5.9	12
Department of Conservation	4.8	6
San Francisco Bay Conservation	4.1	70
Environmental Health Hazard Assessment	2.4	12
Secretary for Environmental Protection	1.9	11
Delta Conservancy	0.8	62
Secretary for Natural Resources	0.7	2
Native American Heritage Commission	0.7	99
Tahoe Conservancy	0.2	2
Subtotals	($871.1)	
Agencywide General Obligation Bond Debt Service	$929.0	
Total General Fund Expenditures	**$1,800.1**	

[a] Reflects percentage of total departmental budget excluding California Energy Resources Scheduling division.

(such as state park fees). For Cal-EPA regulatory departments, the decline in General Fund support mostly reflects the shifting of funding from the General Fund to regulatory fees.

In spite of the declines in the level of General Fund support for these programs, the General Fund still provides significant support in a number of resources and environmental protection departments outside of CalFire. The $110 million proposed for DWR largely goes for flood management purposes, of which about $51 million is for financing of a flood-related lawsuit settlement. For DFG, the $69 million proposed from the General Fund is for a wide variety of activities, including enforcement, habitat conservation planning, and sport fishing and hunting programs. For SWRCB, the $34 million proposed from the General Fund supports a number of water quality management activities, including basin planning and general cleanup programs.

While relatively small in absolute dollar terms, the General Fund continues to be the *primary* means of support for a number of resources and environmental protection departments outside of CalFire, including the Coastal Commission and the California Conservation Corps.

Conclusion. While General Fund support for resources and environmental protection programs are declining overall under the Governor's proposed spending plan, our analysis indicates that there are nonetheless additional opportunities to help the state address its significant General Fund problems. In the sections that follow, we offer a number of specific recommendations for achieving General Fund savings. These reflect both program reductions and opportunities to shift funding from the General Fund to alternative funding sources.

WATER ISSUES

Implementation of the New Legislative Water Package

In the analysis that follows, we (1) summarize the package of Delta and other water-related legislation passed by the Legislature in November 2009, (2) discuss how the legislative package impacts the CALFED Bay-Delta Program (CALFED) and its oversight, (3) summarize CALFED expenditures proposed in the budget, (4) review the Governor's budget proposals explicitly related to the package, and (5) discuss key issues for the Legislature to consider related to financing the legislation.

Recapping the Legislative Water Package

In 2009, the Governor called a special session to focus on solving water-related problems in the state's Sacramento-San Joaquin Delta region. The session resulted in the enactment of five pieces of legislation, covering matters related to Delta governance and land use policies, water conveyance, groundwater management, water rights, and a water bond to be placed on the November 2010 ballot. We summarize the major provisions of the legislative package in Figure 4 (see next page).

Package Addresses Broad Array of Water Issues. As can be seen in Figure 4, the legislative package addressed many fundamental water issues facing the state. For example, the bill related to Delta governance creates the Delta Stewardship Council to manage the state's interests in the Delta, requires the council to develop a Delta Plan to guide the management of Delta resources by multiple state and local agencies, and creates a state conservancy for the acquisitions of

land in the Delta mainly for preservation and restoration of habitat. This bill also requires DFG and SWRCB to provide input to the Delta Plan process on environmental in-stream flow requirements and water quality matters, respectively.

The other bills in the legislative package address water issues that are broader in geographic scope than the Delta. For example, the water conservation bill establishes a statewide target of a 20 percent reduction in urban per capita water use by 2020. (Related conservation provisions also seek greater efficiency in agricultural water use.) Another bill in the package requires increased reporting to the state water boards of water use and unlawful diversions and increases enforcement of water rights at the state level. The groundwater bill requires local agencies to conduct monitoring of groundwater elevations at the basin level, and imposes penalties on counties whose water agencies do not fulfill the monitoring requirements. The legislative package also placed an $11.1 billion general obligation bond measure on the November 2010 ballot. Figure 5 summarizes the bond measure's allocation of funds among various water-related purposes.

Water Bond Not a Financing Mechanism for All Other Components. The water bond, if approved by the voters, could potentially fund some elements of the legislative package (for example, by providing funding for capital improvements that help in meeting the urban water conservation goals). However, the bond issue was not designed to be the financing mechanism for the whole package. For example, other sources

Figure 4

The Major Components of the 2009 Water Package

Bill	Topic	Key Provisions
SBX7 1 (Chapter 5, Simitian and Steinberg)	Delta Governance	• Creates Delta Stewardship Council and Delta Conservancy, and reconfigures existing Delta Protection Commission. • Requires the council to create a management plan for the Delta (incorporating work from existing planning efforts)—the Delta Plan. • Requires development of water flow criteria for Delta ecosystem.
SBX7 2 (Chapter 3, Cogdill)	Water Bond	• Places an $11.1 billion legislative bond on the November 2010 ballot, providing for multiple water program goals. • Reactivates California Water Commission (with continuous appropriation authority for new storage projects).
SBX7 6 (Chapter 1, Steinberg and Pavley)	Groundwater	• Requires groundwater elevation monitoring by local agencies (with guidance from Department of Water Resources). • Bars counties and certain local agencies that do not comply with reporting from receiving state water grants and loans.
SBX7 7 (Chapter 4, Steinberg)	Water Conservation	• Requires a 20 percent reduction in urban per capita water use (and 5 percent overall base reduction—regardless of population) by 2020. • Requires agricultural water efficiency, and changes certain water recycling and stormwater targets.
SBX7 8 (Chapter 2, Steinberg)	Water Diversion/Rights	• Requires increased reporting of water use and water diversion; increases certain penalties for water rights violations.

of funding will have to be found for the ongoing administrative operations of the new Delta Stewardship Council and the conservancy. As another example, the water bond explicitly does not provide funding for the design, construction, operation, or maintenance of Delta conveyance facilities—facilities involving the movement of water either through or around the Delta. We discuss these financing issues in greater detail later in this analysis.

The Legislative Package and CALFED

The CALFED Bay-Delta Program. The CALFED encompasses multiple state and federal agencies that have regulatory authority over water and resource management responsibilities in the San Francisco Bay/Sacramento-San Joaquin Delta region. The objectives of the program are to provide good water quality for all uses, improve fish and wildlife habitat, reduce the gap between water supplies and projected demand, and reduce the risks from deteriorating levees. The program's implementation has been guided since 2000 by what is referred to as the CALFED "Record of Decision"—a legal, environmental planning document that lays out the roles and responsibilities for each participating agency, sets program goals and milestones, and covers the type of projects to be pursued.

In recent years, the Secretary for Natural Resources has been the lead state agency with responsibility for CALFED program oversight, including overall program planning, performance evaluation, and tracking of the progress of these activities. Accordingly, funding for CALFED was provided from the Secretary's budget. Through legislative budget actions, the Secretary assumed the responsibility for oversight of CALFED oversight as well as some program responsibilities that were previously carried out by the California Bay-Delta Authority (CBDA). The CBDA, originally created to coordinate implementation of continuing CALFED- and Delta-related programs, was in effect eliminated several years ago (although not eliminated in statute), when the Legislature eliminated its funding and transferred its responsibilities to the Secretary.

The passage of Chapter 5 (Statutes of 2009, 7th Extraordinary Session) in the new water package means that the new Delta Stewardship Council will take the lead role in providing oversight for CALFED. The CALFED program oversight and coordination staff in the office of the Secretary, as well as CALFED fiscal staff in CalFire, are to be transferred to the council along with related funding. In addition, the CBDA was statutorily eliminated and its responsibilities assigned to the new council.

Budget Reflects CALFED Expenditures Across Many Departments. While the new Delta council will take the lead for oversight of CALFED, multiple state agencies will continue to spend money to carry out CALFED activities. The state agencies have estimated the amounts that would be spent for these purposes (as seen

Figure 5

November 2010 Water Bond Allocation of Funds

(In Millions)

Water supply (storage)	$3,000
Sacramento-San Joaquin Delta sustainability	2,250
Conservation and watershed protection	1,785
Regional water supply	1,400
Water recycling and conservation	1,250
Groundwater protection and water quality	1,000
Drought relief	455
Total	**$11,140**

in Figure 6), including some additional funding amounts requested in the 2010-11 budget plan. Information about these expenditures continues to be compiled by the Delta Stewardship Council by the reporting of the CALFED budget, which cuts across numerous departments.

The Governor's budget plan proposes a number of major changes in CALFED expenditures. For example, there would be a major increase in funding for SWRCB for, among other purposes, the development of Delta flow standards. A major decline for CALFED activities for DWR does not reflect an actual decline in the level of programmatic activity, but rather reflects the fact that three years' worth of expenditures (for 2009-10 through 2011-12) were all appropriated in the budget act for the current year.

Time for a Zero-Based Budget for CALFED. In past years, when CALFED and other Delta-related programs activities were at a major crossroads, the Legislature directed the administration to submit a zero-based budget identifying the proposed expenditures of the various state agencies involved in this programmatic area. The intent was to require the administration to justify all CALFED expenditures and thereby enable better legislative understanding of the overall size of the program and how funds were being expended.

Given the Legislature's new policy direction for the Delta and the recent changes in CALFED program oversight, this is an appropriate time, in our view, for the Legislature to direct the council to submit a similar zero-based budget encompassing all CALFED and Delta-related activities in conjunction with the Governor's submittal of the 2011-12 budget. The budget should include a workload analysis and the goals for each of the state's Delta-related investments. The Legislature would then be in a position to eliminate duplicative or unnecessary activities in favor of those that move the state toward the Legislature's stated policy goals for the Delta.

Governor's Budget Proposals to Implement the New Water Legislative Package

Budget Proposals Total $118 Million. As shown in Figure 7, a total of $118 million is proposed to implement the new legislative water package in the budget year. There are two major components of the budget package:

- ***Capital Projects: $52 Million.*** The budget would allocate $28 million to DWR for the Two-Gates Fish Protection Demonstration Program and $24 million to the Wildlife Conservation Board for Natural Communities Conservation

Figure 6

Proposed CALFED Budget—State Funds Only

(In Millions)

State	2010-11 (Proposed)
Department of Water Resources	$206.2
Department of Fish and Game	69.2
State Water Resources Control Board	11.5
CALFED Bay-Delta Program (Delta Stewardship Council)	8.7
Department of Public Health	3.9
Department of Conservation	3.8
San Francisco Bay Conservation and Development Commission	0.1
Department of Forestry and Fire Protection	—
Total	**$303.5**

Planning projects. Both projects are supported with existing bond funds. (We discuss our concerns with the Two-Gates proposal later in this analysis.)

➢ ***Delta Stewardship Council: $49 Million.*** The proposed funding would come mainly from existing bond funds and reimbursements from other state agencies (including SWP funds). The budget would for the most part continue funding for CALFED activities at the same level that were supported before their shift from other state agencies.

Two-Gates Fish Protection Demonstration Project

The Two-Gates Fish Protection Demonstration Project, which would be jointly funded by the state with the federal government, is designed to install operable gates in the central Delta for fish protection and water supply benefits. The Governor's budget proposes to revert the $28 million in Proposition 84 bond funding that was (1) originally appropriated for the project in the current year in the new legislative water package and (2) replaced those monies with a new appropriation of Proposition 50 funding in the budget year of the same amount. However, the federal government has put the project on hold due to concerns about a scientific review of the proposal. It is uncertain at this time if and when federal authorities will resume funding of the project.

Two-Gates Project Should Be Put on Hold. We recommend that the Legislature approve the Governor's proposal to revert the Proposition 84 bond funding for the Two-Gates Fish Protection Demonstration Project. However, we recom-

Figure 7

Governor's Budget Proposal to Implement the New Legislative Package

(In Millions)

State Agency/Major Activities	Proposed 2010-11 Expenditures
Delta Stewardship Council	
• Creation of the Delta Plan, establishment of the Council, continuation of Delta science programs.	$49.1
Department of Water Resources	
• Reactivation of the California Water Commission, groundwater monitoring, water conservation projects, and the $28 million Two-Gates Fish Protection Demonstration Project.	35.0
Wildlife Conservation Board	
• Continuous appropriation authority for Natural Communities Conservation Planning projects.	24.0
State Water Resources Control Board	
• Increased water rights enforcement, new water diversion reporting, Delta Watermaster Program, and water conservation activities.	5.4
Delta Protection Commission	
• Preparation of an economic sustainability plan.	2.0
Delta Conservancy	
• Establishment of the conservancy and early action projects.	1.3
Department of Fish and Game	
• Development of Delta flow criteria.	1.0
Total	**$117.8**

mend that it not approve at this time the administration's proposal to appropriate an identical amount of Proposition 50 funding for the project. This project should be put on hold until such time as the federal government again agrees to support the project and the state has had an opportunity to reevaluate the proposal.

Evaluation of Governor's Budget Proposals for Delta Stewardship Council

In order to provide context for an evaluation of the Governor's budget proposals for the new Delta Stewardship Council, we believe it is useful to first review two of the Council's core statutory responsibilities—the development of the Delta Plan and its work in connection with the Bay Delta Conservation Plan (BDCP) process. We discuss both of these responsibilities further below, and then comment on the 2010-11 budget that is proposed for the council.

The Delta Plan. The council's main statutory assignment is the development and adoption of the Delta Plan, a planning document to guide state and local agency actions within the Delta. The plan is intended to further the state's goals of ecosystem health and water supply reliability which are to guide the state's actions in the Delta. The plan would guide the state's coordination efforts with other levels of government, and take into account other state Delta planning efforts, including the BDCP process (which we discuss in greater detail below).

The Bay Delta Conservation Plan. As part of its development of the Delta Plan, the council is required to consider the BDCP currently being developed by DWR and a group of stakeholders (including state environmental agencies, local water agencies, and environmental organizations). The council is not required to incorporate the BDCP into the Delta Plan, however, unless certain conditions are met. Specifically, DFG must determine that the BDCP meets the qualifications to be deemed a natural community conservation plan. Also, the BDCP must have been approved as a habitat conservation plan that meets requirements in the federal endangered species law. The BDCP is being developed to create a long-term conservation strategy for the Delta. When complete, the plan would provide the basis for the issuance of endangered species permits necessary to allow operations of both the state and federal water projects in the Delta for the next 50 years.

This BDCP planning process is voluntary. The stakeholders and the departments participating in this planning process are not required to adopt this plan when it is completed. If the BDCP were not adopted, then the state and federal water projects would again be at risk of being held in noncompliance with endangered species laws. These agencies would therefore be required to achieve compliance with endangered species laws by the more traditional regulatory permitting process.

In order to ensure that the Delta Plan and the BDCP mesh well, the council is expected to closely monitor and, to some degree, participate in the BDCP process. However, state law also contemplates that the council will independently review the BDCP and make recommendations as to how it would be implemented.

The Proposed Council Budget. The Governor's budget proposes a total of $49.1 million and 58 positions for the council for 2010-11. Of these positions, 50 are CALFED positions that would be transferred from various state agencies (mainly the Secretary and CalFire) to the council. Eight posi-

tions would be new—the council's seven-member board and an assistant to the chair. The proposed complement of staff is shown in Figure 8. Most of the council's funding would come in the form of bond-funded reimbursements ($29.8 million), direct bond appropriations ($9.7 million), and the General Fund ($5.9 million).

Contract Funding Proposed. The council budget would provide funding for $42.7 million in contracts with outside contractors and other state agencies. Of that total, $16 million (paid for with reimbursements from DWR) would be earmarked for the development of the Delta Plan. The budget also assumes that the council would contract for a project director (at an as-yet-undetermined amount), who would develop a process and schedule to accomplish the Delta Plan, to make presentations to the council, and to ensure integration of the Delta Plan. Under the Governor's budget plan, this contracted project director would report to an executive-level staff member at the council.

The council budget would also continue an existing CALFED contract originally established under the Natural Resources Agency for a BDCP liaison at an annual cost of about $159,000. The contractor would coordinate Delta-related activities among various state and federal agencies and the council, as well as manage public and legislative outreach activities on behalf of the council.

Figure 8

Positions Proposed for Delta Stewardship Council

Executive	19
Administration	14
Science	12
Planning and accountability	8
External affairs	5
Total	**58**

Some Budget Modifications Warranted. In general, we believe the council's budget proposal follows legislative direction regarding the transfer and use of existing resources to establish the council. However, we recommend two modifications to the proposed budget. We find that the work that would otherwise be assigned to a project direction contractor should instead be handled by one or more of the proposed 19 executive-level staff proposed for the council. Accordingly, we recommend reducing the council's budget by $200,000 (bond funds), our estimate of the approximate annual cost of such a contract.

The proposal to continue the current contract arrangement for a BDCP liaison is also problematic. The current contractor for the council is the Metropolitan Water District of Southern California. Contracting with such a major stakeholder of the BDCP could compromise the ability of the council to conduct its BDCP-related work objectively and without the perception that it was being unduly influenced by one party to the BDCP process. Thus, we recommend reducing the council's budget by $79,000 (bond funds) to eliminate the contract for the remaining six months of the contract (June through December 2010). We believe the liaison functions could likewise be handled by one of the council's executive-level staff.

Long-Term Financing Approach Needed

How Will Implementation of the Delta Plan Be Financed? The new legislative water package requires that implementation of the Delta Plan to be developed by the council begin by Janu-

ary 2012. However, the water package did not provide a long-term financing plan (the proposed water bond was not designed to fund all components of the legislative package), including for implementation of the Delta Plan. Thus, it is not clear how implementation of a new Delta Plan would be able to proceed in a timely manner as contemplated in the recent legislation.

As we have noted in the past, we believe development of a long-term plan to guide the state's investments in the Delta is warranted. In the absence of such a plan, it has been difficult for the Legislature to evaluate numerous Delta-related funding requests. The development of a long-term financing plan should await the completion of a number of Delta-related assessments. However, these assessments are now largely complete. The two-year timetable for development and implementation of a Delta Plan makes it all the more imperative that such a long-term financing plan also be developed and put in place.

We also continue to believe that such a financing plan should reflect the implementation of the "beneficiary pays" funding principle, whereby the public and private beneficiaries of a state expenditure pay an appropriate share of costs based on the benefit received. We have elaborated on the analytical arguments for this approach in past analyses of resources issues.

Council Should Develop a Long-Term Financing Plan for Delta Improvements. Based on these findings, we recommend that the Legislature adopt statutory language as a part of the budget directing the council to develop a comprehensive long-term financing plan for state expenditures to implement the Delta Plan in conjunction with the Governor's 2011-12 budget proposal. The plan should identify a long-term funding strategy to support the ongoing operations of the council and the Delta Conservancy. This plan should be based on the beneficiary pays principle and should clearly delineate public versus private benefits of ongoing state operations expenditures and capital projects reflected in the Delta Plan. If new fees are proposed to carry out actions recommended in the Delta Plan, the fees should be reasonable and proportionate to the benefits directly received by the fee payer. Finally, as we have often recommended in the past, bond financing should be used only for capital projects that have long-term benefits, and for reasonable administrative costs related to those capital projects.

The Davis-Dolwig Act—Fundamental Reform Still Needed

Governor's Budget Proposal Should Be Rejected Again

Davis-Dolwig Budget Proposal. The Governor's budget proposes to spend $22.6 million in bond and special funds for recreation and fish and wildlife enhancements in SWP. The funding is proposed in connection with the state's 48-year-old law, the Davis-Dolwig Act (Davis-Dolwig), which states the intent of the Legislature that such activities be included in the development of the statewide water system and that the cost of such activities be a state funding responsibility.

The budget also proposes statutory reforms to the act, in part to provide a dedicated funding source for its implementation. Specifically, the Governor proposes a statutory change to provide an ongoing, annual appropriation of $7.5 million from the Harbors and Watercraft Revolving Fund (mainly funded from boating-related fees and gas-tax revenues) to DWR for Davis-Dolwig costs.

The Governor also proposes a statutory clarification to declare that, absent a legislative appropriation, Davis-Dolwig does not obligate the General Fund or DWR to cover costs for SWP-related recreation and fish and wildlife enhancements. In addition, the administration proposes to delete an existing provision of Davis-Dolwig that states the intent of the Legislature to appropriate monies from the General Fund in the annual budget act for these purposes.

Recommend Again That Proposal Be Rejected. The budget proposal is essentially the same one that was submitted last budget cycle and that was rejected by the Legislature. In our 2009-10 budget analysis and subsequent report, *Reforming Davis-Dolwig: Funding Recreation in the State Water Project*, we reviewed policy and fiscal issues that arise from the way Davis-Dolwig is currently being interpreted and implemented by DWR, and offered our recommendations for legislative action. As we found in our prior analyses, the Governor's latest proposal does not address a number of major problems that we have identified with the implementation of the act. Moreover, we again find that the administration's approach improperly limits the Legislature's oversight role for state expenditures in this area. We recommend that the budget request be denied, and we continue to offer the Legislature an alternative package of statutory reforms to the act.

We first discuss some particular problems we have identified with the Governor's proposal, before turning to our recommendations for Davis-Dolwig reform.

Problems With Governor's Proposal

Inconsistency in Justification for Budget Proposal. The Legislature's review of this budget proposal is complicated by the department's inconsistent claims about whether SWP construction projects are being put on hold due to Davis-Dolwig funding problems.

As there is currently no dedicated state funding source for costs allocated to Davis-Dolwig by DWR, the SWP contractors, who pay most of the costs of SWP, have fronted the monies for these costs over many years on the assumption that they would eventually be repaid by the state. According to documents submitted by the department in support of last year's budget proposal, a lack of a dedicated state funding source for Davis-Dolwig costs has resulted in a situation in which new revenue bonds for SWP construction have been placed on hold, delaying these construction projects. The DWR cited this as a key reason for the adoption of its Davis-Dolwig budget proposals, and made the same statements in meetings with legislative staff and bond counsel. While the department later retracted this statement in legislative budget hearings last April, it has included such statements again as justification for the current budget proposal. These inconsistencies make it difficult for the Legislature to assess the merit of the administration's budget request.

No Guarantee of Any Recreation and Fish and Wildlife Enhancement Benefits. Instead of providing funding directly to recreation and fish and wildlife enhancements (the fundamental purpose of Davis-Dolwig), the $22.6 million in the Governor's proposal is to be used to fund a portion of the total annual budget of the overall SWP. This reflects an accounting method adopted by the department in the 1960s whereby total SWP costs are allocated among the project's beneficiaries. The Department of Finance (DOF) raised concerns about this accounting method as far back as the 1970s. As such, very few physical

recreation facilities (for example, boat docks or campgrounds) or fish and wildlife enhancements would actually be provided with the requested funds. Under the administration's approach, Davis-Dolwig funds would be allocated to pay for such items as an SWP communications system upgrade, an administrative office building, and a pump replacement.

Improper Limits on Legislative Oversight. We are concerned about the proposal to provide authority for ongoing appropriations of funding from the Harbors and Watercraft Revolving Fund (HWRF) without annual review of these expenditures by the Legislature. This approach means that there would continue to be insufficient oversight of the Davis-Dolwig commitments made by DWR and how funds are spent for these purposes. In addition, our analysis indicates that the HWRF has a structural deficit and thus cannot sustain support for these additional funding commitments over time.

Failure to Address Various Problems With Davis-Dolwig Implementation. Finally, we find that the Governor's proposal fails to address a number of problems that we identified in our previous analyses with the implementation of Davis-Dolwig. Specifically, our previous review found that DWR has interpreted the provisions of the Davis-Dolwig Act broadly, and as a result has:

- Over-allocated total SWP costs to recreation, thereby overstating the appropriate public funding share of SWP costs for recreation.
- Incurred operational costs at some SWP recreation facilities without prior legislative budgetary review.
- Allocated some regulatory compliance costs of SWP operations to Davis-Dolwig and the state, rather than including them in charges to SWP contractors.
- Allowed construction to start on costly capital repairs to the Lake Perris Dam without consideration of other potential legislative priorities for spending for recreation programs.

Going Forward: LAO's Davis-Dolwig Reform Recommendations

We recommend that the department report at budget hearings on its inconsistent statements regarding whether the lack of a dedicated funding source for Davis-Dolwig obligations is affecting DWR's bond-funded projects. The department should resolve whether this is a problem that the Legislature needs to address. If it considers this situation to be an impediment to bond-funded projects, DWR should provide specific information indicating which such projects have been delayed and the extent of such delays.

Regardless of how this issue relating to bond-funded projects is resolved, we maintain our view that fundamental reform of the implementation of Davis-Dolwig is still needed for the reasons discussed below. Accordingly, we recommend that the Governor's proposal be denied and that the Legislature adopt alternative actions. Specifically, as discussed in detail in our previous analyses, we recommend that the Legislature:

- Amend the act to specify what are eligible costs under Davis-Dolwig (and hence to be paid for with state funds) and what costs are to be met by SWP contractors.
- Direct DWR to evaluate whether SWP facilities mainly used for recreation can be

divested from the SWP. Moreover, until this and the cost allocation issues cited above are resolved, we recommend that DWR not commit to any new recreation-focused investments in the SWP.

- ➢ Provide clear policy direction on the status of costs previously allocated by DWR to Davis-Dolwig and for which the money has been fronted by the SWP contractors.

Our rationale for these actions is outlined in more detail in our prior reports.

In keeping with the reforms discussed above, we recommend adoption of the Governor's proposal to delete the current provision of Davis-Dolwig stating the intent of the Legislature to appropriate monies from the General Fund in the annual budget act for SWP-related recreation and fish and wildlife enhancements. Such a change, in our view, would clarify the Legislature's intention to determine its program funding priorities on a year-to-year basis in the future, including the allocation of any resources for implementation of Davis-Dolwig requirements.

Flood Emergency Fund Proposal Problematic on Many Fronts

The budget proposes to redirect $1 million of General Fund flood program funding in DWR to create a permanent emergency fund (E-Fund) for flood emergencies. According to the department, this fund would provide expenditure authority to proactively respond to flood emergencies, and allow the department to tap into a newly created special fund for these purposes. Below, we outline the proposal and comment on our concerns about the lack of fiscal controls and basic expenditure criteria for accessing the proposed fund. We also discuss our concerns about how the proposal would undermine legislative oversight of the department's expenditures.

DWR's Flood Management Program and Emergency Response

State's Role in Flood Emergencies. Under current law and practice, the department responds to local requests for assistance related to flood emergencies. This can be after a flood is in progress, or prior to a flood event when imminent failure of a levee seems likely. The department coordinates as a first-responder the deployment of personnel and flood-fighting equipment, and generally coordinates the activities of various levels of government. When called upon, the department uses the state funding available for flood management to position itself for a response, in coordination with other levels of government and other state emergency response entities (such as Cal-EMA). In most circumstances, the state may declare an emergency which triggers assistance from the federal government to offset some of the expenses of the state.

General Fund Support Proposed for Flood Management Activities. The Governor's budget proposes about $40 million from the General Fund for state operations and local assistance for the flood management program (excluding debt–servicing costs for a flood–related lawsuit settlement). This funding would be used by DWR for (1) floodplain management activities, including the identification of land subject to flooding, and encouraging local land use practices that take the existing flood threat into account; (2) management of the Central Valley Flood Protection Board; (3) maintenance of the state–federal system of flood control, including encroachment control and inspection; (4) administration

of local flood control subventions; and (5) flood forecasting and natural disaster assistance.

Legislature Previously Augmented Flood Management Expenditures. In recent years, the department indicated that it had substantial unmet funding requirements in the state's flood control system, particularly with regard to levee capital projects. In the 2005-06 budget, the department proposed a number of increases in funding for these purposes over a three-year period. The Legislature approved each of these budget requests, thereby augmenting the department's flood management funding authority from General Fund, bond funds, and special funds. General Fund support for flood management baseline activities has increased from about $14 million in 2004-05 to about $40 million in the proposed budget (a 184 percent increase). In addition, bond funding for state operations has increased from less than $10 million in 2004-05 to about $95 million in the proposed budget.

Governor's Budget Proposal

E-Fund Proposal. The department's budget has been built in the past on the assumption that three flood emergency events will occur each year at a cost to the state of approximately $500,000 per flood event. The department's activities include providing sandbags, coordinating state flood fighting efforts (including Conservation Corps members), and levee monitoring. However, actual flood emergency events, and the associated costs for the department to respond, vary greatly based on the weather pattern in any given year. The response to a single flood event has sometimes cost the state more than $1 million.

The budget proposes to establish a new $1 million fund, using General Fund resources, which would be used exclusively to respond to imminent flood threats with duration of no more than seven days. The administration would be provided authority to redirect the existing General Fund support for flood management. The Director of DWR could access this new fund, at his or her discretion, to support emergency response activities. Proposed budget bill language would further allow DOF to immediately transfer additional funds (General Fund) to the E-Fund without legislative notification whenever the $1 million appropriation was exhausted.

How E-Fund Fits Within Total Funding for Flood Emergencies. Of the $40 million for flood baseline activities, the department proposes to allocate $12.8 million in General Fund support for flood emergencies, response, and recovery activities, from which $1 million could be redirected by DWR to the new E-Fund. Significant additional funding beyond these resources would be available under the Governor's budget proposal for flood management purposes. This includes additional expenditures for flood system maintenance, risk notifications, activation of the State-Federal Flood Operations Center, and the conduct of feasibility studies for improvements for the state system of flood control. The department would also be provided $211 million in bond funds to evaluate floodplains as well as to complete flood system improvements.

Lack of Compelling Justification for E-Fund Proposal

The department contends that setting up a dedicated funding account for flood emergencies via the E-Fund would improve the likelihood and timeliness of cost recovery from the federal government in flood emergencies. In support of its proposal, the department cites federal

law that requires a state to demonstrate that an emergency has exceeded the state's capacity and resources to respond before it can access federal emergency assistance funding. The department provides that the E-Fund is meant to be a reflection of the state's commitment of resources to respond to flood emergencies and thus of its capacity to respond to an emergency.

However, it is unclear how the E-Fund, as proposed, would accomplish this goal. Since the fund could be augmented—without restriction—with resources at DOF's discretion, it is unclear how the fund's existence could be used to demonstrate to the federal government that an emergency has exceeded the state's capacity and resources to respond in order to trigger federal assistance.

The administration has not cited any specific instance in which the lack of such an E-Fund structure hindered state access to federal emergency funding. We are not convinced that the department's E-Fund proposal would have any effect on the state's ability to access federal emergency funding.

E-Fund Proposal Lacks Fiscal Controls and Expenditure Criteria

E-Fund Proposal Lacks Sufficient Fiscal Controls. As noted earlier, the administration's proposal would redirect General Fund monies from the existing flood management program to a new emergency fund. As we also discussed, DOF would then be allowed to replenish the fund at its discretion with General Fund monies, without any prior notification to the Legislature. We find that this type of "revolving door" funding authority could substantially undermine legislative oversight of departmental expenditures and would provide insufficient fiscal controls. (We have similar concerns about an emergency fund for emergency fire suppression.) We further explain our concerns below.

Funding Impacts to Current Programs Unclear. The department has not explained which current flood management activities would be affected by the redirection of resources to the new E-Fund. While the department states that the level of any current programmatic activity would not be reduced, it is not clear how this could be the case if funding formerly available for these activities were now set aside in the E-Fund. In our view, such changes greatly weaken legislative oversight over state spending in this area.

Basic Criteria and Priorities for Expenditures Lacking. The administration has not explained how monies in the new E-Fund would be allocated or prioritized by the department. According to the department, the E-Fund could be accessed simply when the department determined there was an "imminent threat" of a flood. It is unclear, however, whether this means the department could access the funds to deploy personnel and equipment even if the customary process of declaring an emergency has not yet been completed.

Analyst's Recommendation

Because of the lack of fiscal controls and unclear expenditure criteria to access the proposed new E-Fund, we recommend that the Legislature not approve the proposal. This approach, in our view, would undermine legislative oversight of the department's expenditures for this important state function while providing no demonstrated improvement in the state's access to federal emergency funding.

ENERGY ISSUES

Renewable Energy Requirements: Administration Circumventing Legislature's Authority

California has been at the forefront of promoting the development of renewable energy sources for many years, as demonstrated by the enactment of a state law commonly referred to as the renewables portfolio standard, or RPS. The state's RPS law requires specified electricity providers to increase the amount of electricity they acquire from renewable resources, such as solar, geothermal, biomass, or wind power, either from their own power sources or through the purchase of energy from others.

The adoption of renewable energy procurement requirements raises a number of important and complex policy issues. The Legislature has clearly demonstrated its intention to set state policy in this area in statute. Our review finds, however, that the administration is currently spending state funds, and proposing further such expenditures, to develop new renewable energy procurement requirements that circumvent current legislative policy as reflected in state law. We find that such action is (1) premature until and unless the Legislature adopts a new RPS statute and (2) leading to inefficient duplication of efforts by state agencies and wasteful spending.

In the analysis that follows, we review current RPS law, discuss the administration's recent activity that circumvents that law, and make budget-related recommendations to address this concern.

Current RPS Law

RPS Standard Now Set at 20 Percent. Current law, as amended in 2006, requires each privately owned electric utility to increase its share of electricity generated from eligible renewable energy resources by at least 1 percent each year so that, by the end of 2010, 20 percent of its electricity comes from renewable sources. State law defines what specific types of energy sources are to be considered renewable for purposes of the RPS requirement. (The RPS requirement also applies to Electric Service Providers [ESPs]—companies that provide retail electricity service directly to customers who have chosen not to receive service from the utility that serves their geographic area.)

Enforcing the RPS. Current law requires the California Public Utilities Commission (CPUC) to enforce compliance by the private utilities (commonly referred to as investor-owned utilities, or IOUs) and ESPs with the 20 percent RPS. Only IOUs are required to submit plans to the CPUC that describe how they will meet RPS targets at the least possible cost. The RPS law contains provisions that specifically govern how this policy is to be implemented by state officials. For example, the CPUC is prohibited from ordering an IOU or ESP to procure more than 20 percent of its retail sales of electricity from eligible renewable energy resources. As another example, the RPS law caps the costs that an IOU must pay to acquire potentially higher-cost electricity from renewable sources, regardless of the annual RPS targets.

Publicly Owned Utilities Set Their Own Renewable Energy Standards. Current state law does not require publicly owned utilities to meet the same RPS that other electricity providers are required to meet. Rather, current law directs each publicly owned utility to put in place and enforce its own renewable energy standards and

allows each publicly owned utility to define the electricity sources that it counts as renewable. No state agency can require a publicly owned utility to comply with renewable energy standards or impose penalties if one fails to meet the renewable energy goals it has set for itself.

Vetoed 2009 RPS Legislation. During the 2009 legislative session, the Legislature passed, and the Governor subsequently vetoed, a package of RPS-related bills. These bills—which included SB 14 (Simitian), AB 21 (Krekorian), and AB 64 (Krekorian)—together would have increased the RPS target for IOUs and ESPs to 33 percent by 2020 and also made publicly owned utilities subject to the same RPS targets as these other electricity providers. In his veto messages, the Governor cited his policy concerns about the Legislature's approach to meeting a 33 percent RPS, a target which he nonetheless supported. For example, the Governor contended that these bills unduly limited utilities' use of renewable electricity imported from other Western states to meet California's RPS targets. Even though the legislation was vetoed, the passage of the 2009 measures demonstrated the Legislature's continued intention to set policy in this area through the enactment of new statutes.

Administration's Recent RPS Activity Circumvents Legislative Authority

As discussed below, our review finds that over the last few years, the administration has been involved in a number of activities that, in effect, circumvent the Legislature's policy direction as reflected in current RPS law.

Governor's Two Executive Orders. In November 2008, the Governor issued an executive order calling for *all* providers of retail electricity (thereby including publicly owned utilities) to obtain 33 percent of their electricity from renewable sources by 2020. State government agencies were directed to "take all appropriate actions" to implement this target. In September 2009, after vetoing legislation that would have placed a 33 percent RPS target in statute, the Governor issued another executive order directing ARB to develop a regulation "consistent with" a 33 percent renewable energy target. The executive order indicated that the administration believed that it had the legal authority to establish such regulations under the Global Warming Solutions Act of 2006 (commonly referred to as "AB 32"). The ARB currently is working to develop this regulation.

Executive Orders Cannot Replace or Circumvent Lawmaking. In a recent written opinion, the Legislative Counsel advised us that, as a general proposition, the Governor may not issue an executive order that has the effect of enacting, enlarging, or limiting legislation. In the context of the Governor's September 2009 executive order, we are advised that the ARB may not adopt a renewable energy-related regulation that contravenes, changes, or replaces the statutory requirements of the current RPS law. According to Legislative Counsel, AB 32 does not authorize the ARB to adopt such a regulation. Since current RPS law is very prescriptive in its requirements, this prohibition would severely constrain the ARB in developing its regulation pursuant to the executive order. For example, we are advised by Legislative Counsel that the ARB could not develop a regulation that contravenes the current-law prohibition upon requiring an IOU to procure more than 20 percent of its electricity from renewable sources. Given this legal opinion, in our view it would clearly be inappropriate for the administration to circumvent the existing RPS law

by attempting to implement a new renewable energy standard on its own authority.

Planning Activities. Despite these legal constraints, the administration has been involved in various planning activities that assume an RPS target that is different than the one established in current law. For example:

- The ARB's plan to implement AB 32 (commonly referred to as the AB 32 Scoping Plan) includes a 33 percent RPS as one of its primary measures to achieve the state's greenhouse gas emission reduction goals.
- Multiple Integrated Energy Policy Reports prepared by the California Energy Commission have evaluated the state's ability to achieve a 33 percent RPS.
- The Renewable Energy Transmission Initiative planning group (an administration initiative involving multiple state energy and environmental agencies, public and private utilities, and environmental interests, among others) has conducted its planning work and analysis based on the assumption of the imposition of a 33 percent RPS target.
- The CPUC is moving forward with efforts to implement a 33 percent RPS with respect to the private utilities it regulates, through its Long-Term Procurement Plan process.

Budget Issues

Administration's Spending Related to a 33 Percent RPS. Although the Legislature has not approved a budget request related explicitly to the evaluation or implementation of a 33 percent RPS, the administration has spent significant resources for these purposes and has plans to continue this spending. Figure 9 summarizes these ongoing and proposed expenditures, which would total $4 million in 2010-11 under the Governor's budget proposal.

The ARB estimates that it will spend $1.9 million (from the Air Pollution Control Fund) in the current year and $750,000 in the budget year to develop RPS-related regulations pursuant to the Governor's executive order and the AB 32 Scoping Plan. No specific funding requests for this purpose have been submitted to the Legislature for the budget year. For CPUC, the *2009-10 Governor's Budget* proposed a $322,000 increase for the commission to begin the process of implementing a 33 percent RPS. The Legislature denied this budget request, finding that the proposal was premature, pending enactment of the enabling legislation to establish the 33 percent RPS. However, the CPUC has continued to conduct planning and analysis for a 33 percent RPS, and estimates that it will spend $553,000 (from the Public Utilities Reimbursement Account) in the current year for this purpose ($423,000 for staff costs and $130,000 for consulting fees).

Figure 9

Administration's 33 Percent RPS-Related Spending

(In Thousands)

	2009-10	2010-11
Air Resources Board		
Base budget	$1,900	$750
Proposed budget request	—	—
California Public Utilities Commission		
Base budget	$553	$423
Proposed budget request	—[a]	2,800
Totals	**$2,453**	**$3,973**

[a] Budget request for $322,000 was denied by Legislature.

The CPUC plans to spend $423,000 for staffing costs for these same purposes in the budget year from its existing budget resources. In addition, the Governor's budget includes requests totaling $2.8 million (from the Public Utilities Commission Utilities Reimbursement Account [PUCURA]) for CPUC to implement a 33 percent RPS in 2010-11. These requests include $1.8 million for seven personnel-years in staffing to implement a 33 percent RPS, and $1 million annually (for each of the next five years) to contract for RPS program evaluation and technical assistance.

Administration's Spending Plans Are Problematic. The administration's spending plans discussed above are problematic for a couple of reasons. First and foremost, the expenditures by CPUC and ARB to develop RPS-related regulations are premature given the current statute authorizing a 20 percent RPS. This regulatory activity should not occur until or unless the Legislature enacts a 33 percent standard, and only then should be implemented in a fashion consistent with any policy parameters for a revised RPS that have been established by the Legislature.

The ARB's expenditures to develop a higher RPS are particularly problematic. This is because ARB is delving into a subject matter—renewable energy procurement—that is both outside its area of statutory responsibility and outside its area of technical expertise. The ARB is spending significant funding to work with CPUC to come up to speed on the subject matter of renewable energy procurement. In our view, this is an inefficient use of state resources. These ARB activities also constitute an inappropriate duplication of effort, given that CPUC plans to move ahead at the same time to implement a 33 percent RPS that would apply to the entities that it regulates.

Analyst's Recommendations. Given that the administration's spending plans are both premature and an inefficient and duplicative use of resources, we recommend that the Legislature take the following actions to remedy this situation. Specifically, we recommend that the Legislature:

- Deny CPUC's budget request for an additional $2.8 million (from PUCURA) for RPS-related activity in the budget year.
- Reduce CPUC's PUCURA appropriation (Item 8660-001-0462) by an additional $423,000—the amount the commission anticipates spending from its base budget to implement a 33 percent RPS in the budget year.
- Reduce ARB's Air Pollution Control Fund appropriation (Item 3900-001-0115) by $750,000—the amount the board anticipates spending from its base budget to develop a renewable energy standard regulation in the budget year.
- At budget hearings, specifically direct CPUC and ARB to immediately cease spending funds for the purpose of developing a new renewable energy standard or similar requirement absent the enactment of legislation that authorizes such activities.

Fee Structure for Power Plant Siting Program Should Be Revised

The California Energy Commission (CEC) is charged with the duty of issuing permits for large thermal power plants in the state. Over the past decade, the commission has seen a significant increase in the number of applications for the siting

of new power plants—a trend that is expected to continue. In 2003, the Legislature enacted both a siting application fee and an annual compliance fee to partially support the CEC's siting and compliance activities, with electricity ratepayer funds covering the balance of these costs.

In the analysis that follows, we evaluate the current funding structure for the siting program, and offer our recommendations to revise the process. Our recommendations serve two purposes: (1) to more accurately reflect the direct benefits received from the program by power plant developers and operators and reduce the disproportionate cost burden imposed on the state's electricity ratepayers and (2) address current backlogs in the program and facilitate more timely permitting of such facilities.

Background

CEC's Siting Program's Responsibilities and Workload. The CEC's Power Plant Siting and Certification Program is responsible for licensing thermal power plants of 50 megawatts (MW) or greater, as well as related transmission lines, fuel supply lines, and other facilities. This would include, for example, any natural gas-fired, solar thermal, and geothermal plant that meets the 50-MW threshold, but would not include others, such as hydroelectric, photovoltaic, and wind power. After licensing, the commission is required to monitor compliance of the facility with all applicable federal, state, and local laws, as well as any conditions of certification imposed by the commission. The commission also must approve any modifications, expansions, or requests to reactivate plants that have been closed down, such as for major repairs.

Since 1999, the CEC has seen a significant rise in the number of power plant applications submitted for permitting to its siting program. According to the commission, the program's workload is now four times higher than the historical average. This reflects a combination of factors, including increasing energy demands from a growing population, the need to replace aging power plants, and implementation of the state's renewable energy goals.

The siting program currently has 26 projects under active review, of which 15 are traditional natural gas-fired power plants and 11 are solar thermal power plants. In addition, the commission is also reviewing two major amendments to existing licenses. The commission expects to receive another six to eight power plant applications over the next six months alone.

Solar Thermal Permit Applications Take Longer to Process. The Warren-Alquist Act (the statute establishing the commission's roles and responsibilities) requires that the permitting of all power plants under the siting jurisdiction of the CEC be completed within 12 months of the filing of an application. This requirement applies both to traditional (primarily natural gas-fired) plants and renewable (primarily solar thermal) power plants.

According to the commission, this statutorily required time frame to complete the permitting process has been feasible for the permitting of traditional power plants. However, the commission has found that the permitting of solar thermal power plants (the most common application for renewable generation) can take up to 75 percent more time and resources than is required for traditional power plant applications. One reason is that, because the physical footprint of a typical solar thermal plant is generally much greater than the traditional plant, a more extensive environmental review is generally required for this type of applicant.

Governor's Budget Proposal

The Governor's budget proposes about $27 million for the siting program in 2010-11. As proposed, the vast majority of the program's support ($23.5 million) would come from the Energy Resources Program Account, which is funded by a surcharge assessed on electricity ratepayers throughout the state. Of the remaining funding for the program, $2.5 million comes from the Energy Facility License and Compliance Fund, which is supported by fees charged on electricity generation developers and operators, and $1 million from other miscellaneous sources.

Current Fee Structure No Longer Appropriate

The Energy Facility License and Compliance Fund receives its funding from two sets of fees—(1) the Application for Certification (AFC) fee (a permit application fee) and (2) an annual compliance fee for projects which have already been granted a license. The AFC fee levels are set in statute, and include both a base fee as well as a per-MW charge based on the size of the proposed facility. This fee is adjusted annually for inflation. Current law exempts projects that rely on a renewable resource as the primary fuel source from both the AFC and the annual compliance fees. Our analysis indicates that some aspects of these provisions no longer result in an appropriate funding structure for this program, for reasons we discuss below.

Current Funding Structure at Variance With Beneficiary Pays Funding Principle. When the current fees levied on power plant developers and operators were enacted in 2003, the Legislature established a policy that the state's siting program would be funded with a mix of siting fees and revenues from electricity ratepayers. This mix of funding contributions was considered appropriate because both developers/operators and ratepayers benefit to some degree from the siting program. Power plant developers and operators receive direct financial benefits from the commission's approval of their projects, and are responsible for the commission's ongoing operational costs to ensure that all permits are consistently enforced. Ratepayers benefit to the extent that additional investments in energy infrastructure increase the reliability of the state's electricity system.

Nearly all costs of the siting program were originally borne by ratepayers. When we recommended the enactment of siting fees in 2003, we viewed it as an application of the beneficiary pays funding principle. Under this funding principle, an identifiable individual or group which derives a direct benefit from a state service should pay for that service. In applying this principle to the CEC siting program, we concluded that a permit application fee that covers at least 50 percent of the program's costs would be reasonable given the benefits that accrue to power plant developers. We also recommended the establishment of an annual compliance fee to fully cover the commission's ongoing compliance monitoring costs. The Legislature enacted such fee requirements that year, although not at the fee level we generally recommended.

Seven years later, our analysis finds that a disproportionate share of support—88 percent—is currently coming from electricity ratepayers.

Exemption Has Reduced Revenues, While Potentially Harming Efforts to Develop Renewable Energy. As mentioned above, current law exempts renewable energy facilities from the siting and annual compliance fees. According to the commission, since the end of 2007, the state has foregone over $3.3 million in revenues from

renewable developers that have been exempt from the siting fee. In that same period of time, the fee has generated $6.2 million from traditional power plant developers.

As a result of this exemption, the fee revenues available to support the siting program have not increased in line with its growing workload. The program now has a backlog and the statutory time lines for completing its workload are not being met.

Given these circumstances, the Legislature may wish to consider whether the fee exemption is currently serving its original policy goal—encouraging the development of renewable energy generation. Today, as a result of 2006 legislation, the main impetus for increased renewable energy development in the state has been the state's mandate that privately owned utilities obtain 20 percent of their electricity from renewable energy sources. The fee exemption likely plays a comparatively small role in such decisions given the potential cost, in one case exceeding $1.2 billion, to develop a renewable energy facility.

If the Legislature's goal continues to be to encourage and facilitate the development of renewable energy generation, a more effective strategy would be to repeal the fee exemption and devote the additional resources to addressing the current backlogs in the siting program. Ensuring that renewable energy-related permitting is conducted on an ongoing basis in as timely a manner as possible would probably, on balance, do more to encourage such projects. This approach would also be more consistent with the beneficiary pays funding principle in that electricity ratepayers would shoulder less of the costs of a siting program that should more appropriately be charged to the program's direct beneficiaries.

Analyst's Recommendations. In order to more fully implement the beneficiary pays funding principle and to facilitate more timely power plant siting at the commission, we recommend that the Legislature direct the CEC to incorporate a revised fee structure into the Governor's 2011-12 budget plan. Specifically, the commission should be directed to submit to the Legislature, on January 10, 2011, a proposal for a revised fee structure for both the AFC and annual compliance fees—including the necessary statutory language to implement such changes. The proposal should repeal the current statutory fee exemption for renewable energy generation and revise fee levels so that at least a 50 percent share of the siting program's costs would come from developers and operators. The revised fees should be the same for renewable and non-renewable developers/operators to ensure the EC is meeting the 12-month time period mandated in state law for processing power plant applications.

CALFIRE ISSUES

Governor's ERI and LAO's Fee Alternative

The Governor's budget includes ERI—a proposal to levy a new surcharge on all property insurance policies statewide. The Governor proposes to use the resulting revenues to offset General Fund costs in 2010-11 in CalFire. Beginning in 2011-12, these revenues would also be used to augment state program and local assistance expenditures in three departments with emergency response responsibilities—CalFire, CalEMA, and the Military Department, and to offset General

Fund costs in CalEMA. Below, we evaluate the Governor's proposed new funding mechanism for emergency response, comment on the proposed program augmentations, and offer an alternative fee-based funding mechanism to partially support CalFire's wildland fire protection services.

New Insurance Surcharge Proposed to Fund Emergency Response

New Surcharge Proposal. The Governor proposes to levy a surcharge on all residential and commercial property insurance policies in the state. The surcharge rate would be 4.8 percent of the premium amount. The administration estimates that such a surcharge would generate about $238 million in the budget year and about $480 million per year thereafter.

How the New Revenues Would Be Used. As shown in Figure 10, revenues from the proposed surcharge would be used to offset $200 million of General Fund costs in the budget year. In subsequent years with full-year surcharge revenues, the revenues would be used to offset General Fund costs ($219 million) and to augment state program expenditures ($73 million) in three emergency response departments (primarily CalFire). Beginning in 2011-12, the surcharge revenues would also support a $150 million grant program for local first responders.

Surcharge Is a Tax. Based on our discussions with staff at Legislative Counsel, we believe that this proposal constitutes a state tax increase. Legislative Counsel staff have also advised us that if this proposal were to be enacted, it would

Figure 10
Uses of Governor's Proposed Insurance Surcharge

(In Millions)

	2010-11[a]	2011-12[b]
General Fund Offsets	**$200.0**	**$219.1**
CalFire base budget	*$200.0*	—
CalFire Emergency Fund ("E-Fund")	—	*$150.0*
CalEMA—California Disaster Assistance Act assistance to local governments	—	*69.1*
State Program Expansions	**$0.8**	**$73.1**
CalFire—1,100 seasonal firefighters	—	*$31.9*
CalFire—Various other	—	*18.7*
CalEMA—Wildland fire engines	—	*15.2*
CalEMA—Various other[c]	*$0.8*	*5.1*
Military Department—Fire suppression assets	—	*2.2*
CalEMA-Administered Grants to Local First Responders	**—**	**$150.0**
Deposited Into Reserve	**$37.3**	**$36.5**
Total Revenues	**$238.1**	**$478.7**

[a] Assumes one-half year surcharge revenues, with a March 1, 2010 law change and first payments collected on January 1, 2011.

[b] Reflects full-year surcharge revenues.

[c] Includes surcharge collection and other administrative costs.

CalEMA = California Emergency Management Agency

increase the state's funding obligations under Proposition 98, a constitutional provision mandating a set portion of the proceeds of state taxes to be used to provide specified minimum funding levels for public schools and community colleges. The Governor's budget proposal does not reflect this increased obligation under Proposition 98. Therefore, if the Legislature were to approve the Governor's proposal, it would create a Proposition 98 obligation, and therefore an additional state cost, that is not now recognized in the administration's budget plan.

Recommend Rejection of the Surcharge Proposal. We find that the Governor's proposal to fund certain emergency response activities, largely involving wildland fire protection, with revenues from the proposed insurance surcharge is not a good approach. We therefore recommend that the proposal be rejected. While the Governor's proposal attempts to link a certain levy (the insurance surcharge) to the benefits received by those paying it, we think that there is a much clearer, more direct way of making such a linkage. As discussed later, as an alternative to the Governor's proposed funding mechanism, we offer what we consider to be a true fee—one that links the charge to the benefits received directly by a defined, identifiable group of property owners.

If Legislature Enacts Surcharge, Retain Flexibility in Use of Revenues. Should the Legislature approve in concept an insurance surcharge as a new tax revenue source, we would then recommend that the surcharge revenues be deposited into the General Fund, and that the use of such revenues be governed by the Legislature's funding priorities for General Fund revenues for the particular budget year being considered.

Proposed Augmentations May Have Merit, but Decisions Not Needed Now

Augmentations Are Proposed for 2011-12 and Subsequent Years. The Governor's budget plan proposes various emergency response-related program augmentations that would be supported with the proceeds of the new insurance surcharge. The proposed out-year augmentations for CalFire, CalEMA, and the Military Department are summarized below.

CalFire Augmentations. The Governor proposes five augmentations totaling $51 million to CalFire beginning in 2011-12. The proposals are the same ones presented by the administration in January and May 2009:

- ***Additional Seasonal Firefighters ($31 Million, Ongoing).*** The CalFire engines are currently staffed with three personnel. Under this proposal, during fire season, engines would be staffed with four personnel (a practice currently in place and funded through the E-Fund).

- ***Helicopters ($2 Million in 2011-12; Total of $150 Million Over Six Years).*** Under this proposal, CalFire would replace 11 firefighting helicopters and remodel of two helicopter bases. The CalFire's helicopter fleet is more than 40 years old and is facing increasing maintenance costs and scarcity of spare parts.

- ***Upgrade of the Wide Area Network ($11 Million in 2011-12; Ongoing Costs of Around $3 Million).*** Currently only 5 percent of CalFire location have access to the existing Wide Area Network with the remaining locations connecting via dial-up

technology. Under this proposal, the entire network would be upgraded and extended to cover most CalFire locations.

- ***Automatic Vehicle Locators ($5 Million, Ongoing).*** The CalFire's current dispatch and communications system relies on fire or aircraft crews to report their location to the dispatch center manually. Under this proposal, vehicles would be fitted with a system that would automatically update the dispatch system with the vehicle's location.

- ***Aviation Asset Coordinator ($0.3 Million, Ongoing).*** The CalFire works with the Military Department and federal military agencies to respond with firefighting aircraft. Under this proposal, CalFire would add 1.5 positions to better coordinate these activities between CalFire and other agencies.

CalEMA Augmentations. The Governor proposes these augmentations for CalEMA:

- ***Wildland Fire Engines ($15 Million in 2011-12; Total of $67 Million Over Six Years).*** The administration intends to purchase 131 fire engines to supplement the current CalEMA fleet of about 140 engines.

- ***Additional Staff ($2.6 Million, Ongoing).*** The administration intends to add staff for various emergency preparedness and response activities.

Military Department Augmentations. The Governor proposes these augmentations for the Military Department:

- ***Aerial Fire Suppression Assets ($2.2 Million in 2011-12; Total of $13.5 Million Over Six Years).*** The administration intends to purchase aerial fire suppression assets, including modifications to existing helicopters and airplanes.

- ***Additional Staff ($1.3 Million Beginning in 2012-13, Ongoing).*** The administration intends to add staff for various emergency response activities.

LAO Comments. The administration's may have merit, but none of the proposed augmentations requires the Legislature to act *now* to approve or reject the augmentations. This is because the program augmentations are not scheduled to begin until 2011-12. In any event, the Governor did not submit detailed budget change proposals for many of these out-year augmentations, so the Legislature lacks the required information to evaluate them. Therefore, we recommend that the Legislature make any decision on these proposed augmentations as part of its 2011-12 budget deliberations and in the context of the Legislature's funding priorities for the three affected departments in that year. We also recommend that the Legislature consider each augmentation proposal on its merits separately from discussions on the funding source.

LAO Alternative: Wildland Fire Protection Fee

Implementing the Beneficiary Pays Funding Principle. In the past, our office has offered a number of recommendations for achieving General Fund savings by shifting funding for particular state governmental activities from the General Fund to new or increased fees. While the resulting General Fund savings are clearly a

benefit from adopting these recommendations, we have offered these kinds of recommendations in both good and bad fiscal times. Our analysis finds that these fees are the appropriate funding source, as a matter of policy, for the activities in question. For example, in cases where the state is providing a service directly to beneficiaries, such as wildland fire protection, the application of the beneficiary pays funding principle would have these beneficiaries pay for the costs of the services that directly benefit them.

However, it is important to note that the application of the beneficiary pays funding principle does not imply that fees will necessarily cover the full cost of the state's wildland fire protection. This is because this activity provides benefits to the public at-large (such as by providing habitat protection) as well as directly to a discrete group of identifiable individuals (namely property owners in or near wildland areas). In such circumstances, we recommend that fees be assessed to cover only the portion of costs that can reasonably be allocated to the direct beneficiaries of the state's wildland protection services, with state General Fund resources being used to pay for the broad public benefits. We think that it is very important that any fee be set at levels that are reasonable and proportional in light of the benefit received, and the additional costs imposed on the state, by the individual feepayer. This is the nexus between fee and feepayer that is necessary for an assessment to pass both legal and policy muster as a fee, rather than as a tax.

Below, we discuss our policy rationale for the enactment of a new wildland fire protection fee.

State Is Responsible for Wildland Fire Protection. Under existing statute, the state is responsible for providing *wildland fire protection* in State Responsibility Areas (SRAs). These SRAs encompass about 31 million acres of the state, primarily *privately owned* timberlands, rangelands, and watershed areas. There are an estimated 860,000 homes in SRAs. Initially, CalFire's mission was the prevention and suppression of wildland fires in undeveloped areas. Over time, however, there has been considerable "mission creep" and the department now spends considerable time and resources protecting homes in SRAs from wildfire, as well as responding to medical emergencies and other non-wildfire calls.

Costs of State Fire Protection Have Increased Dramatically. Today, the state's largest General Fund program expenditure in the natural resources area is fire protection. Over the last two decades, the cost to provide fire protection in SRAs has increased substantially. For example, between 1998-09 and 2008-09, the General Fund cost for fire protection (including both the base budget and E-Fund expenditures) more than tripled. In the current year, estimated General Fund fire protection expenditures are $750 million.

Increasing Development in and Around SRAs Has Increased CalFire's Fire Protection Costs. Increasing residential development in and around SRAs has translated to increased CalFire fire protection costs for several reasons. First, with the presence of life and structures in or nearby to the areas for which CalFire is responsible to provide wildland fire protection, more resources are often deployed to suppress wildland fires than would be used in nondeveloped areas. Second, the presence of development can limit the fire prevention and suppression options available to wildland fire managers, thereby potentially increasing the fire risk of an area and increasing fire suppression costs. For example, development substantially restricts the ability

of fire prevention agencies to use certain techniques such as prescribed burning to reduce the high volume of flammable vegetation intermixed with development. Lastly, the presence of people in wildlands can increase fire protection costs because fire from structures, vehicles, and human activities can quickly spread to the wildland vegetation.

Wildland Fire Protection Directly Benefits Property Owners in SRAs. As a matter of practice, local governments are primarily responsible for providing *structural* fire protection in the state, both inside and outside SRAs. This has led some to question what benefit, if any, property owners with structures in SRAs receive from CalFire's *wildland* fire protection services. In our view, these property owners directly benefit from, and impose costs on, CalFire's fire protection activity for a number of reasons. First, if CalFire were not located nearby to help prevent wildfires from reaching the structures and to be as readily available to assist as an emergency responder, then the local fire agencies would need to augment their resources substantially. These increased local costs would be passed on to the property owners under the local jurisdiction by way of increased local assessments. Similarly, without CalFire's presence, property owners with structures in SRAs could face higher property insurance premiums because there would be a higher fire risk to insure against (unless the local firefighting agency stepped up its resources to fill the gap). Finally, the presence of structures in SRAs impacts the way CalFire fights wildfires, and has greatly increased the state's costs in providing its fire protection.

Recommend a New Wildland Fire Protection Fee in SRAs. Property owners in SRAs directly benefit from the protection of their property provided by CalFire. Therefore, we believe it is appropriate that property owners in SRAs pay a *portion* of the state's cost for fire protection. Because the department provides fire protection for natural resources of statewide significance—such as watersheds that provide drinking water for much of the state—it is also appropriate that the state as a whole pay for a portion of the cost of fire protection. Therefore, we consider it reasonable that the state's cost of providing fire protection in an SRA be shared between the direct beneficiaries and the state's taxpayers as a whole.

We recommend that the Legislature enact a fee on the owners of structures in SRAs that would be proportional to the additional costs imposed on the state as a result of the presence of those structures. When determining the level of such a fee for structures in a given area, the Legislature would need to consider actual expenditures made by the department in that area, the local fire risk, and the adequacy of fire protection provided by local governments. We continue to consult with staff at Legislative Counsel about the technical requirements to structure the assessment so that it passes legal muster as a fee rather than a tax. We will share the written opinion that we have requested from Legislative Counsel with the Legislature once it is received. Finally, we recommend that the Board of Equalization (BOE) be authorized to collect such a fee.

Because our recommendation would create a new fee, there would be a significant amount of one-time administrative work by CalFire and BOE to set up the fee-collection mechanism and make the initial determinations of who must pay the fee. It is likely this work would take several months. It may be possible to generate revenues beginning as early as the budget year if the Legislature were to enact our fee recommenda-

tion soon. Otherwise, revenues from the new fee would most likely begin accruing in 2011-12.

Structured as a Fee, LAO Alternative Does Not Create Proposition 98 Funding Obligations. As discussed above, we believe that the Governor's proposed insurance premium surcharge is a tax that would increase the state's funding obligations under Proposition 98. In contrast, our proposed funding mechanism would be structured as a fee and thus would not add to the state's funding obligations under Proposition 98.

For a more detailed discussion of our SRA fee proposal, please see our *Analysis of the 2008-09 Budget Bill,* page B-47.

Improving Legislative Oversight of CalFire's Fire Protection Budget

Background

Role in Fire Protection. The CalFire is responsible for wildland fire protection in SRAs. These SRAs encompass about 31 million acres (about one-third) of the state, primarily privately owned timberlands, rangelands, and watershed areas. In order to provide this fire protection, CalFire employs around 5,000 permanent firefighters, operates an aviation program (aircraft, helicopters, and air tankers), and runs some 230 fire stations.

Two Main Components to CalFire's Fire Protection Budget. The Governor's budget proposes about $1 billion (from all fund sources) for CalFire's fire protection state operations in 2010-11. As discussed in further detail below, this budgeted amount has two components—the "base budget" and an amount budgeted for emergency fire suppression known as the E-Fund. The base budget is proposed to be supported from the General Fund ($300 million) and revenues from a proposed surcharge on property insurance policies statewide ($200 million). The E-Fund is budgeted with a $223 million General Fund appropriation. The additional $277 million consists of reimbursements from local agencies as well as the federal government for fire protection services provided by CalFire.

Base Budget Intended to Pay for Day-to-Day Fire Protection Costs. The CalFire's base budget pays for everyday firefighting operations of the department, including salaries, facility maintenance, and other regularly scheduled costs. Included in the base budget are the costs associated with the "initial attack" on a wildfire—that is, the firefighting operations generally undertaken in the first 24 hours of an incident. Typical costs would include retardants, overtime, and equipment. The base budget is the source of support for personnel costs to staff engines with three firefighters year-round. (The base budget is also used for the support of fire stations that are in operation on a seasonal basis.)

The base budget is subject to annual appropriation by the Legislature and follows normal budget review processes (such as the submission of budget change proposals for consideration by the Legislature).

E-Fund Budget Intended to Pay for Large-Incident Firefighting Costs. Once an incident has gone beyond the initial 24 hours and therefore will likely exceed the capability of containment by that CalFire unit, costs associated with firefighting are charged to the E-Fund. Such costs as equipment rental, unplanned overtime, inmate crews, and additional air support are charged to the E-Fund for large incidents. If there were no large-fire incidents in a given fiscal year, expenditures from the E-Fund in that fiscal year would in theory be zero.

For many of these large incidents, the state is eligible to be reimbursed by the federal government for some or all of the costs. However, the federal reimbursement process can take a number of years. Once federal funds have been obtained, they are deposited into the General Fund, where in effect they offset state firefighting costs. As a result, the E-Fund expenditures that occur in any given year do not necessarily reflect the ultimate cost to the state for these activities during that time period.

The General Fund support for the E-Fund is provided by the Legislature as a separate budget appropriation based on an estimate of the large-incident firefighting costs for the fiscal year. For 2010-11, the estimated expenditure is $223 million. According to the administration, this amount reflects the average of the most recent five years of these costs. The budget act's appropriation item for the E-Fund provides that the Director of Finance can augment the item to pay for emergency fire suppression costs at any time without the approval of the Legislature. The department is required to report actual expenditures from the E-Fund to the Legislature quarterly. However, CalFire does not submit requests for any specific expenditure item from the E-Fund to the Legislature.

E-Fund Budgeting Practice Raises Several Issues

Our review of the department's E-Fund budget proposal finds that the amount requested in the budget is likely to provide a more accurate estimate of the resources needed in the budget year than has been the case with past estimates. However, we are concerned about the expanded use over time of the E-Fund by the department—in particular, its practice of charging day-to-day operating costs not related directly to a large incident to the fund. The practical consequence is that expenditures that would normally be required to be justified in the legislative budget process would escape the Legislature's oversight and budgetary review. We elaborate on these concerns below.

Budgeting of E-Fund Has Historically Underestimated Expenditures. Figure 11 shows by how much the budgeted E-Fund amounts and actual expenditures for emergency fire suppression have underestimated actual expenditures for the last five years. Beginning with the 2009-10 budget year, the administration has changed its methodology to estimate E-Fund costs by using the average of costs from the most recent five years. Given this, the estimate for the E-Fund should more closely reflect the likely costs to be incurred.

Use of the E-Fund Has Been Expanding. Our review finds that, over time, CalFire's E-Fund expenditures have been expanded by the administration to include costs that are not incurred as a result of a large-fire incident.

Figure 11

CalFire E-Fund: Actual Versus Budgeted Expenditures

Fiscal Years 2005-06 to 2009-10
(In Millions)

	2005-06	2006-07	2007-08	2008-09	2009-10[a]
Budgeted amount	$95	$95	$82	$69	$182[b]
Actual expenditures[c]	93	169	372	437	256
Amount Over/Under Budget	**-$2**	**$74**	**$290**	**$368**	**$74**

[a] Estimated.

[b] Amount contained in *2009-10 Budget Act* reflects the Legislature's removal of funding for DC-10 contract.

[c] Does not fully reflect reimbursement for major incidents from the federal government that can take several years to be received by the state.

These costs include:

- ***One-Half of the Aviation Program's Budget.*** One-half of the costs of CalFire's aviation program are generally supported from its base budget, but one-half comes from the E-Fund under a longstanding departmental budget policy. This means that even if there were no large incidents in a given fiscal year, one-half of the costs of the aviation program would be charged to the E-Fund. However, if an aircraft is used for a specific large incident, then any additional costs (such as fuel and retardants) are charged to the E-Fund. One exception is CalFire's contract for a large air tanker—a DC-10—that recently had been supported exclusively from the E-Fund. (See the box on page 40 for a full discussion of the budget issues associated with the DC-10 air tanker.)

- ***Four-Person Staffing.*** As discussed above, CalFire's base budget contains funding for three firefighters per engine. In recent years, CalFire—under an executive order issued by the Governor—has increased staffing on fire engines to four in targeted areas during peak fire season (generally June to October) with resources provided from the E-Fund.

- ***Tahoe Fire Station.*** The California-Nevada Tahoe Basin Fire Commission recommended in its response to the Angora Fire (a 2007 wildfire that burned 3,100 acres and 250 structures on the western side of Lake Tahoe) that CalFire establish a seasonal fire station to improve initial attack on wildfires. The CalFire has implemented that recommendation under an executive order and supported this fire station activation through the E-Fund.

Figure 12 shows the total costs of these different cost items paid for under the E-Fund over the last five years.

Current E-Fund Budgeting Practice at Odds With Original Legislative Intent. As stated previously, if there were no large-fire incidents in a given fiscal year, expenditures from the E-Fund in that fiscal year should in theory be zero. However, the assumption in the administration's budget plan is that certain significant ongoing firefighting costs we have identified would be paid for from the E-Fund even if the state had a year in

Figure 12

A Significant Portion of CalFire's E-Fund Expenditures Were Anticipated[a]

2005-06 to 2008-09
(In Millions)

Cost Type	2005-06	2006-07	2007-08	2008-09
Unanticipated Incident Costs[b]	$77	$155	$324	$381
Anticipated Costs				
Personnel[c]	$3	$1	$23	$33
Half of aviation program	13	12	16	15
DC-10 contract	—	1	9	7
Subtotals	($16)	($14)	($48)	($56)
Totals	**$93**	**$169**	**$372**	**$437**

[a] Split between type of costs as estimated by CalFire.

[b] Costs related directly to large-fire incidents.

[c] Includes four-person staffing of engines and staffing costs of Tahoe firehouse.

which it avoided fire emergencies. For example, the staffing costs of the Tahoe fire station are costs that are not related to a fire emergency. We believe this budgeting practice is at odds with the Legislature's original policy intent that the E-Fund be devoted to paying for costs associated with large-incident emergencies.

Legislature Not Given Opportunity to Review E-Fund Expenditures. The practical consequence of this budgeting practice discussed above is that the Legislature is not being given the opportunity to review the E-Fund expenditures that should more appropriately considered as part of the department's base budget. If subjected to legislative review, some of these expenditures might not have been approved by the Legislature based upon cost-effectiveness concerns or a lack of workload justification. The Legislature might also have chosen to support some proposed expenditures found to have merit from an alternative funding source. The current use of the E-Fund by the department undermines the ability of the Legislature to exercise appropriate oversight of these expenditures.

Recommendations to Improve Legislative Oversight

Given the concerns discussed above, we recommend that the Legislature make two changes to the budgeting of CalFire's E-Fund, with the intent of improving the Legislature's oversight over CalFire's budget:

- Require day-to-day expenditures currently charged to the E-Fund to instead be justified under the department's base budget.
- Improve the budget act controls on the E-Fund appropriation item.

We discuss both of these proposed changes below.

Increase CalFire's Base Budget and Decrease E-Fund Budget. We recommend that the Legislature increase CalFire's General Fund base budget appropriation for 2010-11 by about $60 million (our estimate of day-to-day costs inappropriately charged to the E-Fund), with a corresponding reduction of $60 million in the E-Fund appropriation. We recommend that the Legislature direct the administration to provide the Legislature, in conjunction with the Governor's May Revision, a more precise estimate of the amount of funding that should be shifted from the E-Fund to the base budget to implement this change in budgeting policy. Also, the administration should detail the changes in position authority for seasonal firefighters that should be implemented commensurate with this funding shift.

As noted above, we recommend that whatever amount of funding that is reduced from the E-Fund in the budget year be added to the base budget appropriation. This will provide needed certainty to CalFire that all funding that is needed will be available for the current fire season, which generally runs from May to October. That is, as CalFire will be hiring seasonal firefighters and entering into a contract for the very large air tanker in the current year, our recommended budget adjustment should not impede CalFire's planning for the full fire season that extends into the budget year.

However, given that many current E-Fund expenditures have never been subjected to the normal budget review process, we recommend that this funding issue be revisited in 2011-12. Specifically, the administration should be directed to provide budget change proposals in 2011-12 to fully justify this additional base-budget spending. Consistent

with this approach, any staff positions shifted into the base budget for the budget year should be established on a limited-term basis and any new contracts funded from these monies should not commit state funding beyond the budget year.

Going Forward: Increasing E-Fund Spending Accountability. In tandem with these budgetary changes, we recommend that the Legislature take further steps to ensure that E-Funds are spent solely for large-incident firefighting costs. To accomplish this, we recommend the Legislature adopt statutory language that (1) explicitly specifies what types of expenditures are allowed from the E-Fund and (2) requires that any other expenditures be supported from the department's base budget, where they would be subject to annual appropriation in the Legislature's regular budget review process.

DC-10 Contract Demonstrates How Emergency Fund (E-Fund) Hinders Legislative Oversight

A series of events involving a California Department of Forestry and Fire Protection (CalFire) contract for large air tanker services demonstrates how the current approach to the E-Fund makes it more difficult for the Legislature to ensure its budgeting choices are implemented.

"Call-When-Needed" Contract. For many years, CalFire had a contract for securing large air tanker services for its firefighting activity on a call-when-needed basis. Under this arrangement, the contractor would agree to deploy a firefighting plane that was requested by CalFire within 24 hours, if it was available and not in another state (or country). This contract was tapped if needed to supplement the department's own fleet or large air tankers operated by the federal government.

"Guaranteed Availability" Contract Initiated in 2006. Since 2006, CalFire has contracted with a private firm for a DC-10 air tanker capable of dropping 12,000 gallons of retardant or water on wildfires. The contract cost of around $7 million per year is charged entirely to the E-Fund. Prior to 2006, CalFire had relied on large air tankers operated by the federal government. However, this resource became unavailable after most of the federal fleet was grounded following a number of accidents.

Under the initial multiyear contract entered into by CalFire, the contactor guaranteed that the DC-10 would be available to respond within 20 minutes of a request from CalFire during a specified fire season period (generally June through October). The contract covered fuel and pilot expenses and specified a daily rate for the aircraft to be used exclusively by CalFire.

Contract Cancelled in 2009. As part of the budget-balancing actions taken in July 2009, the Legislature reduced CalFire's E-Fund budget by $6.7 million and directed CalFire to cancel the contract for the DC-10, which the department did immediately. In part, the Legislature's action reflected concerns about whether the DC-10 was a cost-effective firefighting resource to the department. The CalFire then reverted to a previous call-when-needed arrangement for hiring the DC-10.

OTHER ISSUES

Tranquillon Ridge Project Merits Legislative Authorization

The Governor's budget assumes either State Lands Commission (SLC) approval or legislative authorization of a lease for the extraction of oil and gas from state-owned tide and submerged lands off the Santa Barbara coast known as Tranquillon Ridge. In the analysis, we provide more detailed information on the Tranquillon Ridge project, discuss some of the key policy issues that have been raised concerning the project, and assess the reasonableness of the revenue assumptions contained in this budget proposal. We also offer our recommendations on how the Legislature should proceed on this matter.

CalFire Found Call-When-Needed Arrangement Unsatisfactory. The department found that the call-when-needed daily rate was significantly more expensive than the daily rate it had paid under the guaranteed availability contract, even though this represented a reduced commitment by the contactor. Moreover, even at this higher rate, CalFire found that the DC-10 was not always available to meet its firefighting needs. The department then acted, pursuant to an executive order by the Governor, to issue an emergency contract for 90 days (to the end of the fire season) for exclusive use of the DC-10 under the same terms as the original contract for which the Legislature had stricken funding.

2010-11 Budget Restores Funding for an Air Tanker Contract. The Governor's budget proposes to restore $7 million of funding for the air tanker contract (for which there are now two aircraft types available—a DC-10 and a Boeing 747). Rather than allocating the whole contract cost in the E-Fund, however, as it has proposed in the past, the department would split support for this contract equally between the base budget and the E-Fund, based on the department's historical practice of allocating funding for the aviation program. The CalFire is currently in the process of issuing a three-year contract for these services that would run from June 2010 to October 2012.

LAO Comments. Although our analysis found that CalFire has acted within its administrative authority with respect to the DC-10 contract, the department's use of the E-Fund mechanism for this purpose means that legislative *intent* regarding CalFire expenditures has not always been followed. Although the Legislature chose not to fund the DC-10 contract last year, the administration later proceeded to use E-Fund resources for this purpose. This situation also demonstrates the gaps in legislative oversight that result from this budget practice. The Legislature has never reviewed this contract on its merits in the annual budget process. Moreover, CalFire has not presented a budget change proposal, the customary documentation required to justify budget requests, even though part of the funding for this purpose in 2010-11 would come from the department's base budget as well as the E-Fund.

Background: Tranquillon Ridge and State Policy on Offshore Oil Production

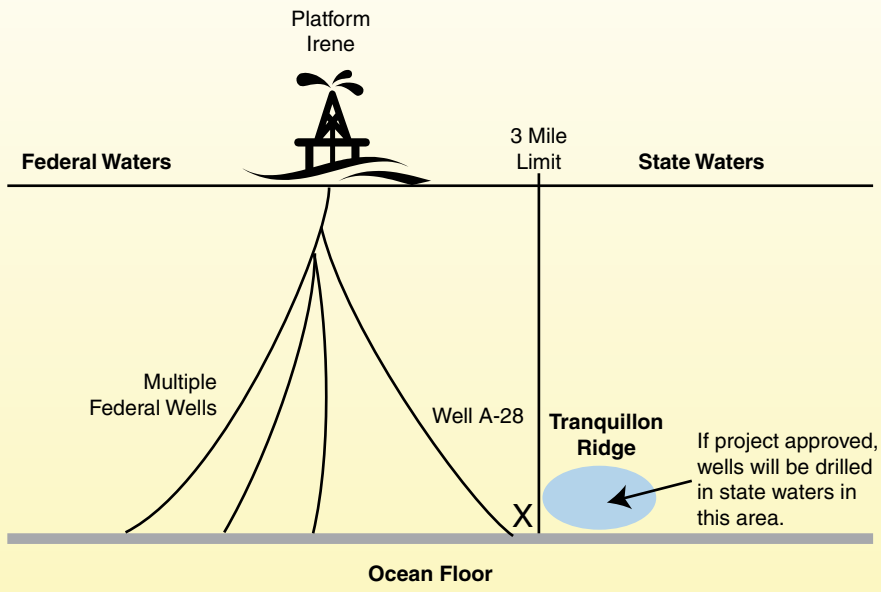
Project Description. Plains Exploration and Production Company (PXP), a Houston-based oil and gas company, has applied for two offshore oil and gas leases covering the Tranquillon Ridge Oil Field, which is located in state waters directly offshore from the Vandenberg Air Force Base in Santa Barbara County. As shown in Figure 13, PXP plans to use their existing platform, Platform Irene, which is located in federal waters, to slant drill 14 wells from the existing structure into state waters in order to access and recover an estimated 40 million to 90 million barrels of oil over a 14-year period. The oil that would be produced from Tranquillon Ridge would be measured separately on the platform and then transported through existing pipelines to a processing plant in the city of Lompoc. There, the oil would be processed to pipeline quality and shipped to refineries through the All-American pipeline.

Legislative Policy Has Prioritized Coastal Protection. Since a major oil spill occurred near Santa Barbara in 1969, California has enunciated a policy that prioritizes the protection of coastal resources over the development of new offshore oil supplies. Over the years, the Legislature has added prohibitions against the leasing of additional offshore areas. In 1994, with the passage of the California Coastal Sanctuary Act, the Legislature generally prohibited any new leases in state coastal waters, with some limited exemptions discussed below. Consistent with this policy, the Legislature has also adopted a series of resolutions opposing new leases in federal waters. The SLC has not approved a new lease since 1968, and since 2001 has similarly adopted numerous resolutions opposing new leases in federal waters. Both the legislative and SLC resolutions often cite the state's record of not approving new leases.

Project Falls Under Statutory Exemption Allowing for New Offshore Oil Leases. One exception to the 1994 California Coastal Sanctuary Act that permits offshore oil drilling in state waters is commonly referred to as the "drainage" exemption. Under this exemption, new drilling is allowed if the SLC, which has authority over

Figure 13

Tranquillon Ridge Project



leasing in state waters, determines that (1) state oil or gas deposits are being drained by means of producing wells upon adjacent federal lands, and (2) the lease is determined to be in the best interests of the state.

The SLC commissioned an independent study to determine whether the proposed Tranquillon Ridge project constituted such an exemption. The study confirmed that such drainage of both natural gas and oil from offshore areas within the state's jurisdiction is occurring due to production from Federal Well A-28, as shown in Figure 13. In addition, the study found that water—which helps pressurize the oil reservoir in state waters—is also being drained. Drainage of this water decreases the productivity of oil production in state waters. Specifically, the study estimates that due to the loss of water, the ability to produce 1.4 million barrels of oil from Tranquillon Ridge has been jeopardized.

Governor's Budget Proposal

Proposed Use of Lease Revenues. The administration estimates that the proposed Tranquillon Ridge lease agreement would generate $1.8 billion in revenues for the state over the lease's 14-year term. The budget assumes quick action to approve the lease in the current fiscal year, so as to generate a fixed up-front payment of $100 million from the lessee in 2009-10 once permits are acquired. The administration proposes to (1) deposit $79 million of the revenues from the up-front payment in the General Fund, where they could be used to support various state programs, and (2) earmark the remaining $21 million to be used in the budget year to restore previous General Fund program cuts in DPR. The budget proposes to use an estimated $119 million in oil lease revenues in 2010-11 for DPR support costs that would otherwise be borne by the General Fund. The administration also proposes language in the budget bill that would backfill the parks program with additional General Fund support in the event that the lease revenues were less than anticipated.

The administration proposes to use the lease revenues in future years to fund state parks. For this purpose, the administration has proposed a statutory change that would require up to $140 million of Tranquillon Ridge revenues annually to be deposited in the State Parks and Recreation Fund to support state park operations. (Any revenues received in excess of $140 million would be deposited into the General Fund.)

How New Proposal Differs From Governor's 2009-10 May Revision Proposal. The Governor offered a generally similar Tranquillon Ridge proposal as part of his 2009-10 budget plan that, ultimately, was not approved by the Legislature. The May Revision version differed from his current proposal in two major respects. First, because the SLC had previously taken administrative action to reject the project, the Governor had proposed that the Legislature adopt legislation that would in effect have overridden that decision. In contrast, this year's budget proposal assumes *either* that the SLC will approve the project (which is being resubmitted to the SLC for its consideration) *or* that the Legislature will authorize it in statute. Second, the May Revision proposal did not dedicate the revenues from the project for any particular purpose. As discussed earlier, the new version of the proposal dedicates the ongoing revenues from the project to fund state parks.

Key Policy Issues

Three major policy issues concerning the approval of the Tranquillon Ridge lease agreement have been raised:

- The risk of oil spills.
- The potential precedent that may be set in support of increased drilling in federal and state waters.
- The potential unenforceability of certain environmental concession provisions in the lease agreement and in a "side agreement" between the lessee and an environmental organization.

We further explain and comment on each of these issues below.

Oil Spill Risk. One policy concern that has been raised with the Tranquillon Ridge proposal is the fact that an increase in the volume of oil production inherently increases the probability of an oil spill. The Environmental Impact Report (EIR) which was prepared by Santa Barbara County for the project found that, if oil were produced from the project for 14 years, the probability of an oil spill during that period associated with Platform Irene would increase from a current 5.4 percent to 11 percent.

However, the volume of the oil spill that could result under this estimate of risk is small compared to the 1969 spill. According to the EIR, the potential worst-case oil spill size related to the Tranquillon Ridge project is estimated to be 7,929 barrels. In comparison, the 1969 Santa Barbara oil spill, which has been attributed to a wellhead blowout, was estimated to involve approximately 80,000 to 100,000 barrels.

Even a spill of small volume however could have a significant impact on coastal resources under certain situations. However, we note that, since the occurrence of the Santa Barbara spill, technological advancements have increased the safety of oil production and new regulatory programs have been established to prevent and respond to oil spills.

Potential Precedent for More Offshore Drilling. As noted earlier, the SLC has often cited the state's record of not approving new state leases in state waters in its opposition to new leases in federal waters. Some opponents of the Tranquillon Ridge project have raised the concern that the approval of this new lease could open the door to additional drilling in state and federal offshore waters.

It is unlikely that approval of Tranquillon Ridge would lead directly to additional drilling within state waters because there are no circumstances similar to Tranquillon Ridge in which drainage is occurring in state waters as a result of production in federal waters.

There is no way to determine at this time whether approval of Tranquillon Ridge could impact federal policy and lead to additional drilling in federal waters offshore of California. However, the approval of new federal leases in the future could potentially create new drainage situations in state waters akin to Tranquillon Ridge. These too would, in theory, be allowable under the statutory exemption contained in the state law governing such situations.

Enforceability of the Third-Party Agreement. As a condition of its support for the project, a Santa Barbara environmental group (the Environmental Defense Center [EDC]) has entered into a written agreement with PXP that attempts to establish and enforce a date upon which oil production in both state and federal waters near Tranquillon Ridge would be terminat-

ed. While the agreement has not formally been made public by the parties to the agreement, the document has been reviewed by SLC staff and the state Attorney General. Public testimony by various private parties and public agencies at a past SLC hearing on Tranquillon Ridge indicates PXP agreed to shorten the time period that it would produce oil from Tranquillon Ridge to one-half the time of the typical lease period for such oil production. The PXP also apparently agreed to a shutdown of production of other wells located in federal waters at a set time in the future.

Both the SLC and the Attorney General have questioned the enforceability of the production termination dates in the PXP-EDC agreement. They note that the U.S. Federal Minerals Management Services (MMS) would need to "sign off" on any termination date, and that the likelihood of such federal action is uncertain. Due to its policy of requiring production to continue as long as recoverable oil remains at an established drilling site, MMS could reject the inclusion of end dates in PXP's application to use Platform Irene for the Tranquillon Ridge project.

Our analysis indicates that these concerns are legitimate. If it chooses to approve this project, in our view, the Legislature should not assume that federal offshore oil production near Tranquillon Ridge will end within the timeline cited in this agreement.

Our Assessment of the Lease Revenue Projections

Projected Revenues Overly Optimistic. As we discussed above, the Governor's budget assumes that an advanced royalty payment of $100 million would be paid to the state in 2009-10, with $119 million in full-year royalty revenues in 2010-11. In so doing, the administration has assumed a March 2010 project approval date for the project.

Based on our review of the situation, we believe such quick approval of the project is unlikely. It is more reasonable to assume that project approval—which entails SLC approval plus other separate state and federal agency approvals—would occur at a date that is several months later. This means that it is unlikely that the advance royalty payment would be collected in 2009-10, although it could occur in the budget year.

In addition, it typically takes several months for newly drilled wells to begin to produce oil. This lag time means that the budget's assumption for a full year of royalty revenues in the budget year from Tranquillon Ridge also is overly optimistic. The revenues from the project could easily be tens of millions of dollars less than assumed in the budget plan.

Revenue Projections for Future Years Are Inherently Uncertain. Given that future oil prices are inherently difficult to predict due to their volatility, so too is it difficult to predict potential revenues from the Tranquillon Ridge lease beyond the up-front payment. The amount of oil produced for the energy market is primarily driven by the price of oil, making it difficult to predict the amount any particular producer is willing to pump in any given year. This, in turn, determines the amount of royalty revenues that would be generated from any particular production site. The budget assumes that, over the planned 14-year production period, Tranquillon Ridge will generate $1.8 billion for the General Fund. However, given the above considerations, this revenue projection is highly uncertain, and could easily range higher or lower by hundreds of millions of dollars or more over the lease period.

Analyst's Recommendations

On Balance, the Project Merits Approval. The Legislature must weigh significant policy and fiscal trade-offs in considering the Tranquillon Ridge project. On the one hand, a certain amount of risk is inherent with the proposed activity, even with the advancements that have been made in drilling technology and the ability to respond to spills. However, a decision to allow the project to proceed would be consistent with the Legislature's current statutory policy, which is to permit an exemption from the general ban on any new offshore oil and gas leases if it is found that state resources are being drained from adjacent federal facilities. Moreover, this project provides the opportunity to gain significant and much-needed revenues for the General Fund that could help to preserve state programs that it considers to be a high priority. Analyzing these potential risks and trade-offs, we find, on balance, that the Tranquillon Ridge project merits legislative approval.

Reject Tie Between These Revenues and Support for State Parks. The administration has proposed to dedicate the ongoing revenues generated from Tranquillon Ridge offshore production to support for state parks. If the Legislature decides to approve the project, however, we recommend that it maintain flexibility in the potential use of revenues received from Tranquillon Ridge. In other words, we recommend that the revenues generated from the project be deposited into the General Fund, where they could be allocated each year in keeping with the Legislature's funding priorities, including, if it so chooses, support for state parks. We believe the Legislature should shy away from unnecessary actions that would lock up these revenues for specific programs. In addition, as we noted earlier, the revenues derived by the state each year from Tranquillon Ridge production could vary significantly from year to year depending on economic conditions, such as the price of oil. That makes it particularly unwise to dedicate these monies to support a program such as state parks that would benefit from fiscal stability.

For these reasons, we recommend that the Legislature not approve the Governor's proposed statutory change dedicating Tranquillon Ridge revenues to fund state parks.

Other Recommended Actions. If the Legislature does decide to approve the Tranquillon Ridge project, it should explicitly authorize the project in legislation, as was proposed by the Governor last year, rather than assume that the SLC will approve it administratively. The SLC's prior decision to disapprove of the project means that future approval by SLC would be uncertain. Enactment of new legislation to authorize the project would ensure that these revenues are available to balance the state budget.

In so doing, the Legislature should seek updated estimates from the administration as to the likely timing of the project and the amount of revenues that would be generated from it in the current and budget years. For the reasons we cited above, we believe more realistic estimates are warranted and necessary to ensure sound budget decisionmaking.

Finally, should the Legislature choose to authorize the project, it should do so if possible through urgency legislation that would maximize the revenues available to provide a state budget solution in the current and budget years.

A Framework for Evaluating Resources Bond Spending

In a resource-constrained fiscal environment, proposals to spend the proceeds of state

general obligation bonds in the budget warrant extra scrutiny by the Legislature. This is for two key reasons. First, bond expenditures come attached with a General Fund cost in terms of debt-service. The state needs to manage and contain these General Fund expenditures, as they compete with and potentially crowd out other legislative funding priorities. Second, given recent history, it is possible that the state will not have sufficient access to the bond markets in the budget year to sell all the bonds that would be needed to fully support all of the bond expenditures contemplated in the budget. Therefore, it will be important that the bond expenditures reflected in the final budget act be well-justified, be an appropriate funding source for the activity in question, and reflect legislative priorities.

In the sections that follow, we provide an update on the status of the fund conditions of various resources general obligation bond measures. (Our numbers incorporate the Governor's various bond expenditure proposals.) We provide a framework for the Legislature to evaluate the Governor's budget proposals and offer recommendations to ensure proper oversight of these expenditures.

A Status Report on Resources Bond Funds

$21 Billion in Resources Bonds Approved Since 1996. Between 1996 and 2006, voters approved seven resources bonds totaling $20.6 billion (Propositions 204, 12, 13, 40, 50, 84, and 1E). In addition, the Proposition 1B transportation bond allocated $1.2 billion for air quality purposes and the Proposition 1C housing bond allocated $200 million for local parks.

$3.2 Billion Would Remain Available for Future Appropriations. As shown in Figure 14, about $3.2 billion is projected to remain available under the Governor's budget plan from the seven resources general obligation bond measures at the end of 2010-11 for appropriation in future years. As the figure shows, funds are substantially depleted from five of these measures. The funds remaining available for appropriation in future years are mainly for (1) flood management, largely in the state's Central Valley and Delta regions (including about $1.5 billion of Proposition 1E funds) and (2) various water quality and water management programs (including about $750 million of Proposition 84 funds). Relatively few funds remain available for state

Figure 14

Resources General Obligation Bonds, 1996 to Present

(In Millions)

Proposition/Year	Allocation	Obligated	Proposed 2010-11	Balance (July 2011)
204 (1996)	$870	$817	$22	$31
12 (2000)	2,100	2,064	14	22
13 (2000)	2,095	1,882	33	180
40 (2002)	2,600	2,544	40	16
50 (2002)	3,440	3,169	104	167
1E (2006)	4,090	2,206	338	1,546
84 (2006)	5,388	3,894	250	1,244
Totals	**$20,583**	**$16,576**	**$801**	**$3,206**

and local parks-related purposes and for land/habitat conservation, restoration, and acquisition—activities carried out mainly by the state's several land conservancies and the Wildlife Conservation Board.

$800 Million of Resources Bond Spending Proposed for Budget Year. As shown in Figure 14, the Governor's budget proposes about $800 million of bond expenditures from these resources bonds. A majority of these expenditures are proposed for flood management and water management activities carried out by DWR. (In addition, the Governor's budget proposes $230 million from the Proposition 1B transportation bond for air quality projects in the state's major transportation corridors.)

Evaluating Bond Proposals

As discussed further below, we recommend the following framework to guide legislative evaluation of the Governor's bond spending proposals:

- Evaluate each proposal to see whether it meets a set of specified criteria before allowing any bond expenditure to be incorporated into the 2010-11 budget plan.
- Set priorities for the expenditure of the bond funds in the event that bond market conditions do not permit all bond-spending proposals to be funded.

Resources Bond Expenditure Criteria. We think that it is important to consider the timing of the Legislature's evaluation of bond expenditure proposals. Although the Governor's January budget includes many requests for new appropriations and reappropriations of bond funds, the bulk of the administration's resources bond-related requests are often submitted as proposed amendments to the budget plan in April and May (mainly as reappropriations) and acted upon during the May Revision process. For this reason, a comprehensive evaluation of proposed bond expenditures should occur upon the submittal of the complete package of bond expenditure proposals.

In its evaluation of proposed bond expenditures, we think that the Legislature should apply a number of basic criteria before approving any expenditure.

First, as with any budget request, we think that the administration should provide sufficient detail in terms of the description and justification for the proposal to enable the Legislature to make an informed decision about its merit. Lacking such information, we recommend that the request be rejected.

The project should address a *current* programmatic need and, consistent with prior statutory direction, be used for capital purposes—particularly for projects that provide benefits over a number of years. The department proposing to spend the funds on a capital project should be ready to spend the funds and capable of completing a project as proposed with the bond resources requested as well as other available funds.

Finally, the Legislature should consider whether bond funds are the most appropriate funding source for the activity in question, or whether there are alternative funding sources available. For example, the application of the beneficiary pays funding principle may suggest that funding from the direct private beneficiaries of the state expenditure is appropriate. Alternatively, federal or local funds may be available that should be used instead of state bond funding.

Applying the Criteria. We applied these criteria to the bond-related requests submitted as part of the Governor's January budget proposal. We raise concerns about bond budget requests in two write-ups elsewhere in this budget analysis—"Implementation of the New Legislative Water Package" and "The Davis-Dolwig Act—Fundamental Reform Still Needed." We outline our concerns about other specific bond budget requests in our *Summary of LAO Findings and Recommendations on the 2010-11 Budget*, a Web-based list which can be found at our Web Site, www.lao.ca.gov.

Prioritizing Bond Expenditures in a Difficult Fiscal Environment. In our office's previous reports and testimony to the Legislature regarding the state's current fiscal situation, we have recommended that the Legislature identify priorities among bond-funded projects. This is particularly important given the likelihood that the state will not have sufficient access to the bond markets in the budget year to sell all the bonds that would be needed to fully support all of the bond expenditures contemplated in the budget. In 2009, this situation resulted in the postponement of the offering of some bonds for sale by the state. This, in turn, significantly delayed a number of state bond-supported projects. Some of these delays are continuing to occur, and more such problems are likely, at least in the near term.

When such constraints interfere with bond-supported expenditures, the current practice is that the administration allocates the available funds according to *its* priorities. For example, according to DOF, the administration has prioritized certain bond sales used to support state program operations and over capital outlay purposes. The administration has also prioritized projects that address fire/life/safety and public health deficiencies, leverage other funds, or provide an immediate economic stimulus and create jobs.

Legislature Should Set Its Priorities. We think that the Legislature should provide direction to the administration on the Legislature's priorities among the resources bond appropriations which it approves, in case some portion of these appropriations cannot be spent due to problems with accessing the bond market. The Legislature might list the particular projects that are its top funding priorities, and then provide its highest priorities for the balance of the appropriations, expressed at a relatively high level. For example, these priorities for the balance might include funding projects which provide direct public safety benefits, or those which create state revenue opportunities (such as projects at fee-generating state parks).

Improving Accountability for DWR's Bond Spending

Substantial Bond Funding Has Been Allocated to DWR. Over the past ten years, various bond measures have allocated over $15 billion of their funds to DWR, with a majority allocated by two measures from 2006. Several billions of dollars remain available from these bond funds for future appropriation to DWR. In addition, the Legislature and Governor recently enacted a measure to place an $11.1 billion general obligation water bond before the voters in November, some of which is allocated to DWR.

Concerns About DWR's Capacity to Manage Large Volume of Bond Funds. These recent increases in the availability of bond funding for DWR are unprecedented in their magnitude. This has led to concerns about the department's capacity to effectively manage such a high level of funding. A 2007 Bureau of State Audits ex-

amination of the Proposition 1E Flood Protection Corridor Program found a number of problems with the way the department administered the program, including poorly defined grant selection criteria, poor monitoring of grants, and a concern that the state overpaid for a particular land acquisition related to flood control. A recent update of the audit found that a number of these concerns had not yet been addressed by the department.

Difficult to Track Department's Bond Expenditures. Our analysis of these programs indicates that it is difficult to account for how bond funding has actually been spent by the department. This is due in part due to the department's practice of administratively shifting funding between different projects and programs. It is not clear that, in all cases, these funding shifts were in line with the Legislature's original funding intent. This practice was particularly evident during a period in 2008-09 and 2009-10 in which bond sales had stopped because of the state's fiscal problems and difficulties in the municipal bond market.

Comprehensive DWR Bond Audit Warranted to Improve Accountability. Given the concerns outlined about the DWR's management of general obligation bond funds, the Legislature may want to request a Joint Legislative Audit Committee review of all of DWR's general obligation bond-funded programs. An audit should focus on ways to improve the efficiency and usefulness of the department's bond expenditure reporting to various state control agencies (such as DOF) as well as the Legislature. We recommend that this audit review be conducted in time to assist the Legislature with its 2011-12 decisions about DWR bond expenditures.

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