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April 2010

Tradable Renewable Energy Credits (RECs) in California: Continued Complexity

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In March 2010, the California Public Utilities Commission (CPUC) issued a long-awaited decision that allows the use of tradable renewable energy credits (RECs) to satisfy certain renewable energy mandates applicable to California utilities and other energy providers.

By allowing RECs to be "unbundled" from the underlying energy, the CPUC's decision could provide more compliance flexibility and create a more efficient energy market. Both compliance requirements and the market, however, remain subject to complexities imposed by the decision itself and by existing regulatory structures that continue to impact renewable energy eligibility in California. Utilities, energy providers, renewable energy developers, and other market participants who understand the opportunities and limitations created by the CPUC's decision will be in the best position to take advantage of the growing renewable energy market in California.

Background

In 2006, with the adoption of Senate Bill (SB) 107, the California legislature required that at least 20% of the total electricity sold to retail customers be generated from eligible renewable energy resources by December 2010. In 2008, the renewable portfolio standard (RPS) established by the legislature was enhanced by Governor Schwarzenegger's issuance of Executive Order S-14-08, which increased the target to 33% by 2020. To help facilitate RPS compliance, SB 107 also gave the CPUC authority to allow the sale of renewable attributes to be unbundled from the sale of the renewable energy itself. In other words, the CPUC was authorized to allow utilities and other load-serving entities (LSEs) to purchase RECs, separate from the energy itself, to meet their RPS compliance obligations.

Since enactment of SB 107, the CPUC has been taking incremental steps towards allowing unbundled RECs to be used for RPS compliance. As a first step, in April 2006, the CPUC initiated a proceeding to define what constitutes a REC. In 2008, the CPUC adopted a decision that defined a REC as "a certificate of proof, issued through the Western Renewable Generation Information System (WREGIS), that one megawatt-hour of electricity was generated by an RPS-eligible renewable energy resource and delivered for consumption by California end-use retail customers." CPUC Decision 08-08-028. The definition clarified that RECs include "all renewable and environmental attributes associated with the production of electricity from eligible renewable energy resource, including any avoided emission of pollutants to the air, soil or water; any avoided emissions of carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, or any other greenhouse gases that have been determined by the United Nations Intergovernmental Panel on Climate Change, or otherwise by

law, to contribute to the actual or potential threat of global climate change, and the reporting rights to these avoided emissions, such as Green Tag reporting rights."

In 2007, the CPUC determined that RECs generated from renewable systems belong to the owner of the renewable systems, even if the owner is a customer of a utility and even if the customer participates in net-energy metering, the California Solar Initiative, or the Self Generation Incentive Program. CPUC staff also held a comprehensive workshop on RECs in September 2007, out of which came a Straw Proposal from staff covering various market and compliance issues. The Straw Proposal became part of the CPUC's ongoing proceeding in considering whether to approve tradable RECs.

As a precursor to allowing RECs to be unbundled, SB 107 required that both the CPUC and the California Energy Commission (CEC) make a determination that the WREGIS tracking system is ready to support the use of tradable RECs for RPS compliance. The CEC made that determination in November 2008 (Resolution E-4178) and the CPUC made that determination in December 2008.

CPUC Tradable REC Decision

Over the last two years, the CPUC has been evaluating how tradable RECs might be used to satisfy RPS requirements. Through that process, various proposed decisions were issued and withdrawn. On March 11, 2010, the CPUC issued its final decision allowing LSEs, including investor-owned utilities, energy service providers and community choice aggregators, to begin procuring tradable RECs to satisfy applicable RPS mandates. See *Cal. Pub. Util. Comm'n, Decision Authorizing Use of Renewable Energy Credits for Compliance with the California Renewables Portfolio Standard*, Rulemaking 06-02-012 (Mar. 11, 2010). Prior to the March decision, which went into effect immediately, LSEs subject to RPS requirements in California had to procure "bundled" renewable contracts that provided for the purchase and sale of energy and RECs together as a package. As a consequence, the CPUC's decision ostensibly gives California LSEs greater flexibility in how they satisfy the State's renewable energy mandates and creates a tradable REC market that previously did not exist in California.

In actuality, however, the use of tradable RECs is still subject to significant limitations. Most importantly, California's investor-owned utilities (PG&E, SCE, and SCG&E) can use tradable RECs for no more than 25% of their annual RPS mandate. In addition, tradable RECs are subject to a price cap and earmarking restrictions. These limitations and restrictions are particularly controversial because, at the same time, the CPUC decision imposed a new interpretation of what constitutes a bundled transaction and what constitutes a REC-only transaction for purposes of RPS compliance. Prior to the decision, out-of-state transactions that delivered the energy into California in compliance with the CEC's firm commitment delivery rules (see explanation below) were most typically treated as bundled transactions. The tradable REC decision reversed that long-standing practice and created a bright line rule that reclassified all out-of-state contracts as REC-only transactions for purposes of RPS compliance.[1] This new interpretation, moreover, applies retroactively. As a consequence, existing out-of-state contracts, previously approved by the CPUC as bundled contracts, now constitute REC-only contracts (subject to the 25% cap on tradable RECs usage by investor-owned utilities).

While many of these requirements are scheduled to sunset on December 31, 2011, there is concern that they are having an immediate adverse impact on both the renewable energy market and the ability of LSEs to satisfy RPS requirements. On April 12, 2010, the investor-owned utilities filed a joint petition for modification of the tradable REC decision, seeking, among other things, a change in the definition of REC-only and bundled transactions and elimination of the tradable REC usage limit. On April 15, 2010 the Independent Energy Producers Association filed a similar petition asking, among

other things, that the CPUC adopt a presumption that transactions using firm transmission qualify as bundled transactions. Responses to the petitions are due on May 4, 2010. In addition, several parties have filed motions for rehearing on the decision.

At the same time, the CPUC has scheduled a tradable REC workshop to discuss: 1) a methodology for comparing REC-only contracts to the price cap if the transaction includes both energy and RECs; 2) standards for reviewing and evaluating bundled RPS contracts that utilize dynamic transfer; and 3) how to classify transactions that include firm transmission arrangements as either bundled or REC-only contracts. Whether through the workshop process or through the petition process, it is clear that many of the impacted stakeholders will continue to advocate for changes to the CPUC tradable REC decision.

Existing CEC RPS Eligibility Rules Continue to Apply

In California, the CPUC is empowered to authorize, by rule, the use of RECs to satisfy the state's RPS. See *Cal. Pub. Util. Code § 399.16(a)*. The CEC, however, has been given the independent authority to determine whether a facility generating renewable energy qualifies as RPS eligible. As a result, any facility seeking CEC certification must submit a completed application and supporting documentation to the CEC, which will review the application to determine the facility's eligibility as a renewable supplier under the California RPS. See *CEC Renewable Portfolio Standard Eligibility Guidebook (January 2008)*.

Renewable energy facilities must show that their energy complies with the CEC's eligibility requirements. For out of state facilities, the CEC requirements are particularly significant. An out of state facility must demonstrate delivery of its power into California. Specifically, facilities must show "delivery of its [energy] generation to an in-state market hub or in-state location as specified in the 'Delivery Requirements' as outlined in the RPS Eligibility Guidebook." See *Cal. Energy Comm'n, Form CEC-RPS-1A:S3: Certification Supplement 3 – Out of State Facilities, p. 1 (Jan. 2008)*.

The CEC guidelines expressly provide that "to count generation from out of state facilities for RPS compliance, the RPS-certified facility must enter into a power purchase agreement with a retail seller, procurement entity or third party, and a matching quantity of electricity must be delivered" to California. *Guidebook at p. 24.* To satisfy the delivery requirement, the CEC allows for the use of firming and shaping and provides that the firming and shaping can be performed by the facility, by a third party or by the retail seller. *Id. at p. 23.* The CEC gives 3 examples of how these firming and shaping transactions can be structured. *Id. at 23-24, n. 21.* Under all three examples, the facility's electricity is "unbundled" from its RECs, but only after the purchaser buys the RECs and electricity as a bundled commodity from the facility under an initial power purchase agreement.

California's RPS statute gives the CEC sole responsibility for determining RPS eligibility, including establishing the criteria for delivery of RPS-eligible electricity. (*Cal. Pub. Util. Code § 399.13*.) The CPUC's decision expressly acknowledges that it has no authority to modify the CEC's delivery rules and emphasizes that "both REC-only and bundled transactions must meet all RPS eligibility criteria." *CPUC Decision at 29-30.* Yet, some parties have argued in their modification petitions and rehearing motions that, notwithstanding the CPUC's assertion that it is not modifying CEC requirements, by reclassifying out of state transactions as being REC-only contracts (rather than bundled contracts), the CPUC is essentially overriding CEC jurisdiction to regulate delivery requirements.

Whether the CPUC decision will cause the CEC to modify its rules is yet to be seen. It is possible that the CEC could modify its guidance to either broaden or restrict its interpretation of statutory delivery requirements and/or provide further clarification based upon the CPUC decision. We understand that the CEC does intend to update its Guidebook in the next several months, but at this point the agency has not indicated what changes are likely to be proposed.

WREGIS Requirements

Those interested in buying and selling RECs will also need to comply with the operating rules that WREGIS has issued. Among other things, the operating rules establish the procedures that must be followed to record a REC onto a WREGIS Certificate. Similar to a REC, a WREGIS Certificate is defined as "all Renewable and Environmental Attributes from one MWh of electricity generation from a renewable energy Generating Unit registered with WREGIS or a Certificate imported from a Compatible Registry and Tracking System and converted to a WREGIS Certificate." To be registered with WREGIS, a generating unit must be within Alberta, British Columbia, Washington, Oregon, California, Nevada, Idaho, Utah, New Mexico, Arizona, Colorado, Wyoming, Montana, parts of Texas, South Dakota, Nebraska, and the northern portion of Baja, Mexico, and it must use renewable fuel, as defined by the state or province where it is located. Each state and province is responsible for determining whether a particular generating unit qualifies for their RPS program. States and provinces may upload a file of eligible generating units into the WREGIS system or manually verify eligibility.

In addition to paying applicable fees, generators must satisfy the following WREGIS requirements:

- Complete initial registration of the generating unit (this is how the generator creates an account in WREGIS)
- Information in the initial registration must be verified by WREGIS and updated on an annual basis by the generator
- Except for small customer-sited units (which can self report), generators must have their generation data reported by a Qualified Reporting Entity (QRE) – QREs can include balancing authorities, interconnecting utilities, scheduling coordinators, and independent third party meter readers – to qualify, QREs must enter into an agreement with WREGIS and follow QRE guidelines
- 100% of the output from a single meter of the generating unit must be reported and tracked by WREGIS
- All of the certificates created by the generating unit must be deposited into the active WREGIS account for that unit
- Once in an active account, the REC can be transferred to another active account, retired, exported to a compatible trading system (to the extent such systems are established in the future), or placed in a reserve account to withdraw the REC from circulation without retiring it
- Once retired (i.e. used to show compliance with an RPS program or other voluntary program), RECs are no longer transferable

Summary

As a result of the CPUC's recent tradable REC decision, many LSEs now have added flexibility to comply with RPS requirements. The limitations imposed on investor-owned utilities, however, may undermine the extent to which tradable RECs are used and could create additional complexity in the renewable energy market. As the CPUC petition and workshop process continues, the landscape for tradable REC usage in California is likely to change further. Stakeholders who closely track the intricacies of the evolving California regulatory structure will be best able to develop effective market strategies.

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[1] Although the CPUC decision includes transactions that provide for dynamic transfer of renewable energy into California within the scope of bundled transactions, the California Independent System Operator (CAISO) does not yet have the federal and regional approvals necessary to implement a dynamic transfer process.