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Matthew Freedman

TURN
THE UTILITY REFORM NETWORK
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Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95814

To the Board,

The Utility Reform Network (TURN) has deep concerns about the proposed Renewable Electricity Standard (RES) considered for adoption at the next Board meeting. TURN urges the California Air Resources Board (CARB) to cease work on the RES until the legislature provides clear statutory direction to proceed with such a far-reaching program. If CARB is determined to adopt the RES notwithstanding this opposition, it should remedy several serious omissions and failings in the current proposal prior to adopting any program.

TURN is an independent non-profit consumer advocacy organization devoted to promoting affordable, effective and sustainable energy policies. TURN staff have participated in the development of California renewable energy policy for decades and, over the past 8 years, have been active in the implementation of the California Renewables Portfolio Standard (RPS). TURN has participated in relevant rulemakings at the California Public Utilities Commission (CPUC), appeared before the California Energy Commission (CEC), and provided testimony to the California Legislature. For the last 8 years, TURN has also served on the Procurement Review Groups (PRGs) of the three major investor-owned utilities regulated by the CPUC and, through that process, has reviewed substantial volumes of confidential material addressing the mechanics of renewable procurement transactions and the pricing, supply and types of renewable power being offered to buyers in western power markets.

While the proposed RES is intended to fill a gap left by the absence of statutory authority to require a 33% portfolio under the existing RPS program, the rules and accompanying documents are rife with serious omissions, unreasonable assumptions, wishful thinking and unwarranted exemptions. Moreover, the RES would create a "regulatory void" for load-serving entities regulated by the CPUC and fails to establish meaningful, uniform procurement requirements for all

entities covered under the rule. Finally, the RES is vulnerable to being eliminated or severely weakened on short notice as a result of legal challenge, new Board appointments, the inclusion of new technologies in the list of eligible resources (e.g. nuclear, large hydro), an Executive Order issued by any future Governor, voter initiative or a variety of other political developments.[1]

Without a robust statutory framework, market participants and non-market stakeholders will lack confidence that critical rules governing compliance, resource eligibility and targets will remain in place for the duration of the program. This confidence is critical to inducing long-term investments and promoting sustained business growth that will ultimately benefit consumers and the state's environmental quality.

In the following sections, we highlight our major objections and concerns with the RES.

THE RES CREATES A REGULATORY VOID FOR LOAD-SERVING ENTITIES REGULATED BY THE CPUC

The RES rule fails to provide any clarification regarding the division of responsibilities between CARB and CPUC for oversight of Investor-Owned Utilities (IOUs), Community Choice Aggregators (CCAs) and Electric Service Providers (ESPs). Although the RES establishes high-level eligibility standards and overall renewable energy targets, the CPUC has direct oversight of these retail sellers, is responsible for establishing applicable procurement rules and continues to possess enforcement authority over compliance with the 20% RPS program. Furthermore, the CPUC has established a long-term resource planning effort for the three major IOUs and will be approving specific resource plans to guide each utility in achieving renewable energy targets.[2]

The RES rules raise serious questions about which agency is responsible for actually overseeing procurement strategies and adopting specific direction regarding resource mix, contract terms, contract approvals, and allowable costs. It also raises the likelihood of conflicting rules and directives issued by the two agencies. Absent clarifications, TURN expects retail sellers to attempt regulatory arbitrage by pitting the two agencies against each other at every possible opportunity in order to undermine legitimate CPUC oversight of renewable procurement activities. To the extent that CPUC authority over resource planning is undermined by this exercise, such an outcome would invite a legal

[1] Based on the outcome of the CARB process, TURN will decide whether to pursue a legal challenge to the final RES rule.

[2] The CPUC has also indicated that ESPs will be required to submit renewable procurement plans.

challenge of the RES and create a prolonged period of uncertainty as to whether the 33% target is enforceable.

At a minimum, the RES should clarify that the CPUC may establish any reasonable procurement rules associated with achieving the 33% target by any retail seller (IOUs, ESPs, and CCAs) consistent with the scope of its authority under the 20% RPS program. The CPUC's authority should include any rules limiting Tradable Renewable Energy Credits (TRECs), establishing cost caps, adopting long-term resource plans, allocating RES penalty costs to shareholders, and approving or rejecting individual contracts based on their benefits to consumers.

THE LACK OF ANY MECHANISM FOR COST CONTAINMENT IS UNACCEPTABLE

The RES lacks any explicit cost containment provisions. In the event that market prices become highly elevated through either constrained supply or market dysfunction, there should be a limit on renewable procurement obligations. Cost caps are a feature of the current RPS program and were an essential component of every single legislative proposal to expand the goal to 33% by 2020. The absence of this constraint within the RES is significant and disturbing. To the extent that prices do become unreasonably elevated, there must be a safety valve to protect retail customers.

The RES should allow the CPUC and local governing boards to establish a cost containment mechanism using uniform triggers that allow load-serving entities to constrain their renewable energy procurement if the impact on rates becomes greater than anticipated. The development of such a mechanism will take time and require significant analysis, none of which has been performed as part of the RES rulemaking.

IT IS INEXCUSABLE TO ALLOW MUNICIPAL UTILITIES TO COUNT INELIGIBLE RESOURCES TOWARDS ANY PORTION OF RES TARGETS

The RES would allow certain "Qualifying POU Resources" to count towards the renewable procurement targets so long as the resource was claimed for RPS compliance by the Publicly Owned Utility (POU) prior to September 15, 2009. This exemption is totally unwarranted and essentially rewards bad behavior by the POUs that knowingly sought to claim ineligible resources towards their 20% RPS targets. TURN understands that there are a few cases where the POU reasonably believed that generation would be eligible under the CEC guidelines (e.g. landfill gas projects) and does not object to these resources being RES eligible. But there is no justification for permitting large hydroelectric output to count towards any portion of the RES.

POUs have long been aware of the RPS resource eligibility rules and are familiar with the fact that large hydroelectric projects are not, have never been, and would never be eligible to count towards RPS targets. Any POU attempting to claim procurement from such projects towards the fulfillment of the 20% RPS target was knowingly acting in bad faith. The CARB should not reward this type of behavior by grandfathering ineligible resources under the RES program. Such an outcome sends exactly the wrong message to all load-serving entities by encouraging them to take advantage of any manufactured ambiguities in the law without consequence. Moreover, this exemption essentially punishes the POUs that acted in good faith by complying with the statutory definitions and not attempting to count ineligible resources. It is fundamentally unfair to allow certain rogue POUs to count resources that cannot be claimed by any other load-serving entity. The CARB should therefore remove this sweetheart provision from the final RES program rules.

THE ASSUMPTIONS REGARDING FUTURE RENEWABLE RESOURCE PORTFOLIOS AND OUT-OF-STATE GENERATION ARE HIGHLY UNREALISTIC

Perhaps the most flawed element of the RES rule involves estimates of how much generation is likely to be procured from outside California under various scenarios. The staff report claims that the increase in out-of-state procurement under the 33% RES is likely to be minimal relative to a 20% RPS scenario. In total, the incremental increase in out-of-state procurement is estimated to be approximately 1,450 GWh/year under a low load scenario. This estimate is fundamentally flawed because it makes several unwarranted assumptions:

- The RES calculator assumes that 100% of renewable energy contracts already executed by the IOUs and POUs will come to fruition on schedule.[3] This assumption is 100% guaranteed to be wrong and cannot be relied upon as a reasonable input to such an analysis. As the CARB should be aware, many contracted projects are struggling and a number of contracts have already been substantially modified or cancelled. In their latest renewable procurement plans, the IOUs have provided the CPUC with estimates of future portfolios using far lower success rates (for example, 70%) to provide more realistic scenarios. Not only is it appropriate to model a success rate below 100%, but the CARB should also assume a higher failure rate for in-state projects to reflect the greater challenges associated with in-state project development. Changing this assumption to more closely reflect reality would have a significant impact

[3] RES staff report, page V-29 ("For the purpose of this modeling exercise, the ARB has assumed that these resources will be developed on schedule. Therefore, there is little need for utilities to contract for incremental out-of-state resources.")

on the quantity of incremental procurement assumed to occur under the RES.

• The use of POU resource plans submitted to the CEC is not a sound basis for projecting the future resource mix serving these entities under the RES. TURN has observed significant shifts in POU resource planning assumptions over short periods of time as markets evolve and political leadership changes. It is highly likely that generic resource assumptions will be rendered irrelevant as actual projects are proposed. Future POU resource acquisitions will be heavily influenced by the eligibility rules under the RES. To the extent that there are no delivery or product limitations, POU procurement is certain to include far more out-of-state products than anticipated in the CEC-submitted resource plans.

• There are no forecasts of ESP procurement to meet the RES. The supporting documents concede that ESP procurement occurs primarily (or exclusively, as TURN believes) through short-term contracts and that "staff cannot make an assessment of future progress for ESPs."[4] Given that ESPs could serve a sizeable fraction of the retail market in the coming decade, this omission is very significant. Given the ESP focus on short-term contracting and preference for unbundled RECs over bundled renewable power, it should be assumed that practically all their procurement will come from unbundled RECs and that a high proportion of such RECs will be produced by facilities outside California. The failure to make any such assumption is another fatal flaw with the RES calculator.

• The RES calculator modeling assumptions do not accurately reflect the pricing, quantity, competitiveness and availability of out-of-state renewable energy resources currently available to California load-serving entities. The RES calculator claims to select future resource additions based on "the delivered cost of energy to California" and concludes that there would be only a slight increase in out-of-state renewable resources relative to the 20% RPS scenario.[5] Based on confidential information available to TURN through participation in IOU Procurement Review Groups, it is clear that there are a large number of highly competitive out-of-state renewable projects that are not needed to meet a 20% RPS but are likely to be contracted to meet the 33% RES <u>if no delivery or product limitations are included in the final rules</u>. Current competitive offers from out-of-state resources would yield quantities <u>far in excess</u> of the total

[4] RES staff report, pages V-13.

[5] RES staff report, page V-17 ("The RES Calculator then sorts resources based on the delivered cost of energy to California. This includes the cost of generating the electricity, transporting it across the transmission system, and integrating it into the California electricity grid.")

incremental out-of-state procurement estimated by the RES calculator through 2020. This stark divergence between the model forecast and actual commercial reality demonstrates that the RES calculator is not reliable and cannot be used to accurately predict future resource additions.

The entire exercise of determining the economic and environmental impacts from the RES is flawed because the forecasts produced by the model are entirely disconnected from commercial realities. The failure to include any sensitivities (such as high contract failure rates and far higher proportion of anticipated procurement from out-of-state resources) means that the RES documents project a near-perfect scenario for quantifying in-state benefits. As a result, the CARB cannot reasonably reach conclusions regarding the expected reductions in criteria pollutant and toxic air emissions within California. Similarly, the conclusion that 80% of new renewable resources will be built in California (and would create between 8,000 and 10,000 new jobs) is not reasonable.[6] It is disturbing that CARB has no plan to ensure that any particular level of benefits be realized for California as part of the RES. Absent specific conditions on the products eligible to be used for RES compliance, CARB should have little confidence that the predicted in-state benefits will actually be achieved.

THERE IS NOT SUFFICIENT CREDIBLE ANALYSIS ON THE IMPACT OF ALLOWING UNLIMITED REC-ONLY TRANSACTIONS

The RES rule fails to place any restrictions on the use of unbundled RECs based on the assumption that the absence of any restrictions will have "little difference in the resource mix, in-state versus out-of state resources, or emission reductions."[7] This conclusion defies logic and is inconsistent with real-world observations regarding the procurement of REC products under the RPS program rules. The fundamental flaw is that this analysis presumes very little incremental procurement (based on perfect success with existing contracts, ignoring ESP needs and relying on POU generic plans) while also inaccurately projecting the cost-competitiveness of out-of-state RECs relative to bundled in-state resources. Based on reviewing confidential data from IOU procurement activities, TURN does not believe that the economic comparison of out-of-state unbundled RECs to in-state bundled products is consistent with commercial market realities.

Moreover, the CARB analysis overlooks several important factors:

- Due to their inability to enter into long-term contracts and their bias against bundled transactions, ESPs will rely almost exclusively on

[6] RES staff report, page ES-4.
[7] RES staff report, page ES-9.

unbundled RECs under short-term contracts to meet their RES targets.

• New transmission additions are under active development that could significantly expand the ability to interconnect wind resources in Wyoming. Specifically, TransCanada and Anschutz are pursuing a variety of new transmission projects (Zephyr, Chinook, and TransWest Express) intended to interconnect up to 9,000 MW of new wind projects with the intention of selling this output to California load-serving entities. None of these projects are included in the RES analysis.

• The regional penetration limits for wind projected by E3 are not consistent with bids received by IOUs for new projects to be developed in various WECC subregions. These "limits" should be considered highly unreliable for planning purposes.

• There is no discussion of the reduced price hedging value under a REC-only transaction. The RES assumes that allowing unlimited REC transactions yields savings but fails to consider that consumers receive no protection against wholesale market volatility when renewable procurement does not involve a fixed-price energy product. A key purpose of the original RPS law was to promote stable retail prices through contracts for fixed-price energy under long-term contracts.

Finally, the CARB proposal falls well outside the bounds of proposals discussed at the CPUC and in the legislature. In both forums, a wide variety of stakeholders (including the Governor) agreed that REC-only transactions should be subject to limits. By proposing no restrictions at all, the RES stands at odds with the positions of other agencies, elected officials, and most of the key stakeholders. TURN strongly advises a change in this position to bring the RES closer to the proposals being debated in other forums.

SUMMARY OF TURN RECOMMENDATIONS

TURN's primary recommendation is that CARB should defer further action on the RES pending legislative consideration of a 33% RPS bill. The infirmities of an administrative process backed by the executive order of an outgoing Governor should be obvious. It would be a mistake to adopt a 33% renewable energy standard through a process that could be stayed, overturned, rescinded or drastically modified on short notice. Absent legislation providing a clear and stable framework for the achievement of a 33% renewable energy goal, adopting the proposed RES could prove destabilizing and actually diminish the likelihood of achieving a durable statutory solution.

If CARB is determined to adopt an RES in 2010, TURN recommends that the

following elements be included or modified:

- Require that a minimum of 75% of RES compliance come from renewable resources either directly connected to a California Balancing Authority (CAISO or LADWP) or scheduling incremental energy into California in real-time without the use of substitute energy. The outcome of such a requirement appears to be consistent with the E3 modeling results and should ensure that renewable energy developed to meet the RES is providing specific environmental, consumer and economic benefits to California. By setting a minimum percentage, CARB can ensure that actual program results do not deviate significantly from the *ex ante* expectations.

- Clarify that the CPUC may establish any reasonable procurement rules associated with achieving the 33% target by any retail seller (IOUs, ESPs, and CCAs).

- Allow the CPUC and POU local governing boards to adopt meaningful and uniform cost containment mechanisms.

- Decline to permit POUs to count the procurement of ineligible resources (specifically large hydro) towards any fraction of their RES targets.

We appreciate the opportunity to share these thoughts and would be happy to discuss our concerns further with CARB staff.

Respectfully submitted,

MATTHEW FREEDMAN

_____/s/_____

The Utility Reform Network
711 Van Ness Avenue #350
San Francisco, CA 94102
Phone: 415-929-8876 x304
matthew@turn.org

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