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California Takes Another Step Towards Allowing the Use of Tradable RECs for RPS Compliance

The California Public Utilities Commission (“CPUC”), by defining what constitutes a renewable energy certificate (“REC”) under the state’s Renewables Portfolio Standard (“RPS”), is making progress towards allowing electric corporations and, by extension, their seller counterparties to use unbundled RECs to satisfy RPS obligations. *Decision on Definition and Attributes of Renewable Energy Credits for Compliance with the California Renewables Portfolio Standard*, R.06-02-012 (Aug. 21, 2008). To date, California has not allowed electric corporations to meet RPS requirements using tradable RECs that are unbundled from renewable energy sources (“TRECs”), in part, because it had to define what constitutes a REC. That step is now complete.

California established its RPS in 2002 and accelerated its implementation in 2006. California’s RPS currently requires electric corporations to increase supply from eligible renewable energy resources by at least 1% of their retail sales annually until they reach 20% by 2010. Current discussions could raise the threshold to 33% by 2020. When first implementing the RPS, the CPUC asked whether it should allow inter-utility REC trading. Because it could not address all of the issues associated with implementing REC trading by the year-one RPS contract solicitation deadline, the CPUC deferred the matter noting that it might implement REC trading in the future. Since that time, California has addressed a variety of issues related to TRECs, but has not adopted a rule that allows the use of TRECs for RPS compliance.

In its order, the CPUC defines what constitutes a REC for RPS purposes. The CPUC will draw on this definition when it ultimately addresses the terms and conditions for using TRECs to meet RPS requirements. For now, the new definition modifies Standard Terms and Conditions (“STC”) Number 2 of power purchase agreements for bundled energy (energy, RECs, and all Green Attributes) for compliance with the California RPS program. The definition is:

- A renewable energy credit (REC) for compliance with the California renewables portfolio standard (RPS) is: a certificate of proof, issued through the Western Renewable Generation Information System, 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. A REC includes all renewable and environmental attributes associated with the production of electricity from the 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 order to conform to statutory delivery requirements applicable to RPS-eligible supply, the CPUC ordered that RPS-eligible electricity underlying a REC must be delivered to a retail seller, CAISO, or a local publicly-owned utility. Thus, the following energy sources can give rise to a REC: generation from RPS-eligible facilities in state; RPS-eligible distributed generation consumed on-site by a California customer; and generation from RPS-eligible facilities located outside California that meet the California Energy Commission’s (“CEC”) RPS delivery requirements.

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The CPUC clarifies that, “Although avoided emissions are included in the definition of the REC, this definition does not create any right to use those avoided emissions to comply with any GHG regulatory program.” The CPUC thus recognizes that a REC can reflect avoided emissions because a fossil fuel plant may not need to run due to power available from renewable generation, but acknowledged that the California Air Resources Board (“CARB”), is the agency with authority to address whether and how renewable generation can be used as an offset for GHG compliance. For now, the CPUC has confirmed that although a REC may serve a variety of purposes, the holder can use it only once (*e.g.*, if the REC is retired for California RPS compliance, RPS compliance in another state, or is used as an offset for GHG emissions, the entire bundle of environmental attributes represented by the REC is retired). It is possible that California will allow environmental attributes to be disaggregated in the future and, if so, the CPUC will modify its rules accordingly.

The CPUC’s definition of a REC also defines Green Tag reporting rights as “the right to report the ownership of accumulated Green Tags in compliance with federal or state law, if applicable, and to a federal or state agency or any other party and include without limitation those Green Tag reporting rights accruing under Section 1605(b) of the Energy Policy Act of 1992 and any present or future federal, state, or local law, regulation or bill, and international or foreign emissions trading program.”

Like other REC programs, the CPUC creates a list of exclusions of the types of rights that are not conveyed as part of an RPS-eligible REC. The first exclusion essentially separates the REC from the other rights associated with the renewable energy in a manner comparable to what is seen in many agreements involving renewable energy and the allocation of environmental attributes:

- Any energy, capacity, reliability or other power attributes of the generation; any tax credits or other financial incentives in the form of credits, reductions, or allowances associated with the generation that are applicable to a state or federal income taxation obligation; any fuel-related subsidies or “tipping fees” or local subsidies received by the generator for the destruction of particular preexisting pollutants or the promotion of local environmental benefits; or emission reduction credits (whether issued pursuant to § 40709 of the Health and Safety Code or any other authority) that are encumbered or used by the generator for compliance with local, state, or federal operating and/or air quality permits.

The next two exclusions appear to be intended to avoid double rewarding emissions reduction efforts:

- Any emissions reduction credit issued pursuant to § 40709 of the Health and Safety Code (offsets related to air pollution control systems for stationary sources established by state air quality districts).
- Any credits or payments associated with the reduction of solid waste or treatment benefits created by the use of biomass or biogas fuels, which includes GHG emissions reductions from livestock waste (California Climate Action Registry protocol) and the combustion of solid biomass such as agricultural or wood waste.

The remaining exclusions address transactions that do not result in the creation or transfer of an RPS-eligible REC:

- A credit resulting from electricity generated by an eligible renewable energy resource where that resource used nonrenewable fuels to generate the power underlying the credit, except where such use involved a *de minimis* quantity of nonrenewable fuels as determined by the CEC.

- A REC created based on electricity generated pursuant to a contract with a California retail seller or a local publicly-owned electric utility executed before January 1, 2005, unless the contract contains explicit terms and conditions specifying the ownership or disposition of the RECs.
- A REC created based on any electricity generated pursuant to a contract with a qualifying facility pursuant to the Public Utility Regulatory Policies Act of 1978 that was executed after January 1, 2005. However, QF power remains RPS-eligible.

The CPUC also makes some other technical amendments to the RPS contract's STC Number 2. The revised terms can be found in Appendix B of the August 21, 2008 order.

Finally, the CPUC enumerated the additional issues it needs to resolve as part of allowing electric corporations to use TRECs to satisfy RPS requirements. These include:

- Examining the pros and cons of using TRECs for RPS compliance;
- Working with the CEC to ensure compliance with statutory tracking requirements for TRECs;
- Reviewing the STCs for RPS contracts to examine whether and how they need to be modified to reflect the use of TRECs for RPS compliance;
- Working with the Western Renewable Energy Generation Information System on consistency issues associated with REC definitions;
- Working with CEC and CARB on the interplay between RPS procurement and GHG accounting as part of the state's GHG reduction implementation efforts; and
- Addressing any other issues that may arise as a result of new state, regional or federal RPS and GHG initiatives.



If you have any questions regarding this alert, or the services we provide, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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