LATHAM & WATKINS

Number 1178 April 25, 2011

Client Alert

Latham & Watkins Environment, Land & Resources Department

Governor Brown Signs Landmark Bill Raising California's Renewables Portfolio Standard to 33 Percent by 2020

Introduction

On April 12, 2011, Governor Jerry Brown signed Senate Bill 2[1] to increase California's Renewables Portfolio Standard (RPS) to 33 percent by 2020, among the most aggressive renewable energy goals in the United States.[2] The new RPS requires regulated sellers of electricity to procure 33 percent of their total energy supplies from certified renewable resources[3] according to the following schedule:

Compliance Period	New RPS[4]
Through Dec. 31, 2013	20 percent
Dec. 31, 2013 to Dec. 31, 2016	25 percent
By Dec. 31, 2020, and in each year thereafter	33 percent

Senate Bill 2 represents a substantial new statutory requirement that will have significant ramifications on energy markets, electricity generation and transmission line development in California and throughout the western states. The California Public Utilities Commission (CPUC) has estimated that a 33 percent by 2020 RPS will require almost a tripling of current renewable generation from 27 terawatt hours in 2009 to 75 terawatt hours in 2020, potentially necessitating $115 billion in new infrastructure investment including at least seven new major transmission lines at a cost of $12 billion.[5]

"Senate Bill 2 represents a substantial new statutory requirement that will have significant ramifications on energy markets, electricity generation, and transmission line development in California and throughout the western states."

Key Changes and Implications of the New RPS

Originally enacted in 2002, California's RPS previously set a 20 percent by 2010 standard (referred to as the Previous RPS).[6] The Previous RPS covered the state's three large Investor Owned Utilities (IOUs)—Southern California Edison, Pacific Gas & Electric and San Diego Gas & Electric—as well as Community Choice Aggregators and Electric Service Providers.[7] Notably, the Previous RPS did not cover Publicly Owned Utilities (POUs), such as the Los Angeles Department of Water & Power.

In addition to raising the RPS to 33 percent by 2020, Senate Bill 2 implements a number of other important changes that will impact how renewable resources are developed, transmitted and purchased under the RPS program. Significantly, over the long term, Senate Bill 2 contemplates that no more than 25 percent of a California retail seller's renewable portfolio come from resources located out-of-state (with some narrow exceptions). While the CPUC has discretion under certain

Latham & Watkins operates worldwide as a limited liability partnership organized under the laws of the State of Delaware (USA) with affiliated limited liability partnerships conducting the practice in the United Kingdom, France, Italy and Singapore and an affiliated partnership conducting the practice in Hong Kong and Japan. Latham & Watkins practices in Saudi Arabia in association with the Law Office of Mohammed A. Al-Sheikh. Under New York's Code of Professional Responsibility, portions of this communication contain attorney advertising. Prior results do not guarantee a similar outcome. Results depend upon a variety of factors unique to each representation. Please direct all inquiries regarding our conduct under New York's Disciplinary Rules to Latham & Watkins LLP, 885 Third Avenue, New York, NY 10022-4834, Phone: +1.212.906.1200. © Copyright 2011 Latham & Watkins. All Rights Reserved.

defined circumstances to permit up to 35 percent of a utility's renewable resources to come from outside California, the minimum in-state procurement features of the RPS are quite significant even if that action is taken.

Accordingly, Senate Bill 2 should be beneficial to owners and developers of resources within California, who will face more limited competition from out-of-state projects.

In addition, the longer-term ineligibility of most out-of-state projects for the RPS could impose a particular hardship on POUs in their renewables procurement. Unlike IOUs, POUs typically cannot enter into power purchase agreements (PPAs) for *in-state* energy projects prior to the adoption of an environmental clearance for project under the California Environmental Quality Act (CEQA). For that reason, many POUs have in recent years entered into PPAs for out-of-state energy projects. The longer-term ineligibility of most out-of-state projects for the RPS will likely make the POUs' past alternative of procuring renewables from out of state an infeasible approach.

The following summarizes the key changes:

Publicly Owned Utilities Covered By New RPS

Under Senate Bill 2, the RPS now also covers POUs, which will be responsible for implementing the requirements through their own governing boards. This represents a significant expansion of the RPS because POUs currently serve approximately 25 percent of the state's electricity customers.[8] Although many POUs have already been pursuing significant renewables procurement,[9] the inclusion of POUs after Senate Bill 2 is expected to increase demand for development of renewable resources in California and the western states.

Senate Bill 2 Increases Compliance Flexibility But Continues to Restrict Long-Term Use of Out-of-State Renewable Resources

Senate Bill 2 mandates that regulated entities obtain maximum and minimum allocations of the following three types of renewable energy resources to comply with the new RPS:[10]

1. *In-State and Limited Out-of-State Renewable Resources.* This type of renewable resource includes those that: (1) have a first point of interconnection with a California balancing authority,[11] have a first point of interconnection with distribution facilities used to serve end users within a California balancing authority area, or are scheduled from the eligible renewable energy resource into a California balancing authority without substituting electricity from another source;[12] or (2) have an agreement to dynamically transfer electricity[13] to a California balancing authority.[14] Senate Bill 2 mandates minimum allocation requirements for this type of renewable resource to satisfy the RPS:

- At least 50 percent of their renewable energy supplies until December 31, 2013;
- At least 65 percent during the December 31, 2014 to December 31, 2016 compliance period; and
- At least 75 percent thereafter.[15]

2. *Tradable Renewable Energy Credits (TRECs).*[16] TRECs represent the renewable attributes of renewable generation that can be bought or sold in a market-based trading regime separate or "unbundled" from the underlying electricity.[17] Senate Bill 2 sets maximum limits for using TRECs:[18]

- Up to 25 percent of RPS requirements until December 31, 2013;
- Up to 15 percent during the December 31, 2014 to December 31, 2016 compliance period; and
- Up to 10 percent thereafter.[19]

3. *Out-of-State Firmed and Shaped Renewable Resources.*[20] This type of renewable resource involves combining energy schedules from a renewable energy resource (typically located out-of-state) with a non-intermittent, traditional energy resource to address the intermittent nature of wind and solar generation and facilitate the firm delivery and scheduling of energy into California (this process is often referred to as "firming and shaping").[21] Senate Bill 2 appears intended to allow firmed and shaped electricity to satisfy compliance obligations for the portion of a utility's compliance obligation that is not required to be satisfied pursuant to the minimum allocation requirements described in paragraph 1, above.[22]

Overall, the allocations in Senate Bill 2 will likely increase compliance flexibility for regulated entities during the initial two compliance periods (*i.e.*, until December 31, 2016), and provide a certain degree of additional flexibility thereafter. Under the Previous RPS, most procurement from out-of-state renewable resources was limited by the CPUC's policy determination that most out-of-state procurement constituted unbundled TRECs, coupled with the CPUC's temporary cap on TRECs.[23] Under Senate Bill 2, however, regulated entities will have greater flexibility to procure out-of-state resources using TRECs or firmed and shaped electricity, particularly through December 31, 2016, when up to 50 percent (through December 31, 2013) and then 35 percent (through December 31, 2016) of RPS compliance can be met with out-of-state renewables procurement. The initial compliance periods notwithstanding, long-term RPS obligations (*i.e.*, after December 31, 2016) must be satisfied with 75 percent in-state renewable resources (or out-of-state resources that fit narrow exceptions) and only up to 10 percent of compliance from TRECs. These long-term restrictions on procuring out-of-state renewables may continue to make compliance difficult in light of the inherent difficulties of obtaining approvals in California for infrastructure projects as well as increased costs of such compliance.[24]

RPS Compliance Obligations May Be Waived by the CPUC

Senate Bill 2 authorizes the CPUC to assess penalties on non-POU sellers[25] that fail to procure sufficient renewable energy resources to comply with the RPS requirements.[26] However, Senate Bill 2 incorporates protections for CPUC-regulated sellers who encounter difficulties in complying. The Previous RPS allowed the CPUC to delay compliance requirements for up to three years if certain conditions were satisfied.[27] In contrast, Senate Bill 2 allows for a potentially unlimited waiver of compliance obligations if these sellers can demonstrate that any of the following conditions are beyond their control and will prevent timely compliance:[28]

- Inadequate transmission capacity for delivery of sufficient renewable energy
- Unanticipated permitting, interconnection, or other related delays for renewable energy projects or an insufficient supply of eligible renewable energy resources available to the retail seller
- Unanticipated curtailment of renewable energy necessary to address the needs of a balancing authority

The CPUC cannot approve this waiver unless the seller demonstrates that it has "taken all reasonable actions under its control" to ensure compliance.[29] In a similar manner, the CPUC has the discretion to approve lowering the portfolio allocation requirements discussed above, *provided, however*, that in no instance can the CPUC reduce the minimum requirement for in-state (or limited out-of-state resources) to

less than 65 percent.[30] The seller must demonstrate to the CPUC that it requires the reduction for reasons outside its control.[31]

The applicability and usefulness of these relief provisions will likely depend on whether sellers can demonstrate to the CPUC that they have taken all reasonable actions to achieve compliance because at least one, and probably all, of the enumerated constraints will likely continue to apply for the foreseeable future.

Investor Owned Utilities May Construct and Own Renewable Resources

Senate Bill 2 expressly provides for IOUs to apply to the California Public Utilities Commission to construct, own and operate eligible renewable resources in order to meet unmet RPS compliance requirements, up to a level that represents 8.25 percent of the entity's retail sales by Dec. 31, 2020.[32] To date, the vast majority of development has occurred by independent wind, solar and other renewable energy companies. This new feature of California's RPS policy—by expressing a legislative approval for IOUs to build and own a significant number of MWs of new generation to serve the state's renewables mandate—may impact the dynamic of who builds and owns renewable resources within the state.

Expedited Permit Review for Renewable Projects by The California Department of Fish and Game

The Previous RPS goals placed tremendous strain on the California Department of Fish and Game to ensure that new renewable energy projects complied with the state's natural resource laws.[33] Given the California Department of Fish and Game's limited resources to handle the deluge of applications, a number of energy generation and transmission projects critical for progress towards California's RPS goals experienced significant delays.[34] To address these delays, Senate Bill 2 includes organizational changes to the California Department of Fish and Game creating an "internal division with the primary purpose of performing comprehensive planning and environmental compliance services with priority given to projects involving the building of renewable energy resources."[35] The creation of this new division to expedite review of renewable projects may alleviate resource shortfalls, bolstering California's ability to meet its aggressive renewable electricity goals.

New RPS Likely Pre-empts Renewable Electricity Standard

On September 15, 2009, former Governor Arnold Schwarzenegger issued an executive order directing the California Air Resources Board to adopt regulations that would require California utilities to meet a 33 percent renewable energy target by 2020.[36] On September 23, 2010, the California Air Resources Board unanimously adopted a Renewable Electricity Standard to require most retail sellers of electricity to procure 33 percent of their electricity from renewable resources by 2020.[37] Although the Renewable Electricity Standard adopts many of the same requirements as the Previous RPS, it is a separate requirement from the RPS and is intended to increase compliance flexibility and the availability of out-of-state renewable resources.[38] With the enactment of Senate Bill 2, however, it appears likely that that the Renewable Electricity Standard will be repealed by the California Air Resources Board or pre-empted by the new RPS.[39]

Some Implications for Publicly Owned Utilities

Under CEQA, decisions by POUs to enter into PPAs for power from *in-state* energy projects generally are considered discretionary actions in furtherance of a project.[40] For such projects, a POU typically must wait until the lead agency adopts a CEQA clearance for the project before entering into a PPA or, alternatively and where the California Energy Commission does not have exclusive jurisdiction, assert lead agency status and prepare its own CEQA clearance, which POUs have not traditionally done. By contrast, IOUs are not subject to CEQA in entering into PPAs (only the CPUC's later approval of the PPA is subject to CEQA).[41] Accordingly, POUs have for many years faced a significant disadvantage in comparison to IOUs in the competition to enter into PPAs.

In past years, POUs have often been able to properly conclude that entering into a PPA for power from an out-of-state energy project was not subject to CEQA and that therefore the POU could lawfully enter into a PPA even at an early stage in a project's development. Senate Bill 2 does not change the CEQA analysis, but the longer-term ineligibility of most out-of-state projects for the RPS will make procurement from out-of-state projects less practical. For example, a 10-year PPA signed in 2011 for a project with a commercial operation date of January 1, 2012 would only have five years of operation before the utility buyer would only have 25 percent eligibility for out-of-state procurement, and five years is not likely to be a long enough term for any project to get financed. Senate Bill 2 should result in greater competition among buyers to get PPAs with in-state projects. In that competition, the POUs will generally have to wait until a later date (CEQA clearance) to enter into a PPA, by which date the developer may have long since signed a PPA with an IOU. Accordingly, Senate Bill 2 could impose a particular hardship on POUs in their renewables procurement.

Conclusion

The new RPS represents a significant new statutory requirement for California's retail sellers of electricity that will have important ramifications on power producers, transmission line development and energy markets throughout the western states. Senate Bill 2 significantly expands the RPS by covering POUs. Senate Bill 2 also likely increases compliance flexibility compared to the Previous RPS for the initial compliance periods but ultimately may continue to restrict access to out-of-state renewable resources, potentially making compliance more difficult and raising costs by limiting the majority of procurement options to in-state facilities. Moreover, Senate Bill 2 expressly provides for regulated Investor Owned Utilities to apply to the CPUC for the option of constructing and owning their own renewable generation facilities to meet a portion of unmet RPS compliance obligations. We will closely track these issues and are available to advise clients accordingly.

Endnotes

1 SBX1 2, Cal. Leg., 1st Extraordinary Sess. (Cal. 2011). The new law was authored by Sen. Joe Simitian (D-Palo Alto). It was approved by the State Senate on Feb. 24, 2011 and by the Assembly on Mar. 29, 2011.

2 The State of Maine has a 40 percent by 2017 renewable portfolio standard that is arguably more stringent than California's RPS. *See* Department of Energy, Energy Efficiency & Renewable Energy, last visited on April 6, 2011, at: http://apps1.eere.energy.gov/states/maps/renewable_portfolio_states.cfm.

3 Cal. Pub. Res. Code § 25741(a)(1). Renewable resources can include facilities that generate electricity from "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."

[4] The new RPS requires regulated parties to procure a percentage of their electricity sales from eligible renewable energy resources that meets or exceeds the percentage required by the applicable standard during the applicable period.

[5] California Public Utilities Commission, 33 Percent Renewables Portfolio Standard Implementation Analysis Preliminary Results at 1-4 (June 2009).

[6] *See* S.B. 1078, Gen. Assem. 2002, Reg. Sess. (Cal. 2002); Cal. Pub. Util. Code § 399.15(b)(1), *repealed and replaced by* SBX1 2 (Cal. 2011).

[7] *See* Cal. Pub. Util. Code § 399.12(g), *amended by* SBX1 2 (Cal. 2011) ("'Retail seller' means an entity engaged in the retail sale of electricity to end-use customers located within the state, including any of the following: (1) an electrical corporation . . .; (2) a community choice aggregator . . . ; or (3) An electric service provider . . . .").

[8] *See* SBX1 2 Bill Analysis, Senate Energy, Utilities and Communications Committee (Feb. 15, 2011), at: http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0001-0050/sbx1_2_cfa_20110214_141136_sen_comm.html.

[9] *See* California Energy Commission Report, "The Progress of California's Publicly Owned Utilities in Implementing Renewable Portfolio Standards Consultant Report," December 2008 (updated September 2010), available at: http://www.energy.ca.gov/2008publications/CEC-300-2008-005/index.html.

[10] The new procurement allocations in Senate Bill 2 apply to power purchase agreements (PPAs) between regulated utilities and eligible renewable facilities executed after June 1, 2010. For PPAs originally executed prior to June 1, 2010, the contract will count in full towards the new RPS requirements if the following conditions are met: the renewable energy resource was eligible under the rules in place as of the date when the contract was executed; the contract has been approved by the California Public Utilities Commission (if necessary), even if the approval is after June 1, 2010; and any amendments or modifications occurring after June 1, 2010 must not increase the capacity or expected annual generation being sold. See Cal. Pub. Util. Code § 399.16(d).

[11] A "balancing authority" is an entity, typically a public utility or an independent grid operator, such as the California Independent System Operator (CAISO), that maintains real-time balance between the electric demand on the system (load) and generation supply.

[12] Cal. Pub. Util. Code § 399.16(b)(1).

[13] "Dynamic transfer" refers to the technical ability of one balancing authority (*e.g.*, the CAISO) to receive the output of a generation facility physically located in an adjacent balancing authority area and to adjust the schedule and dispatch of the facility when there are fluctuations in the facility's actual output.

[14] Cal. Pub. Util. Code § 399.16(b)(1).

[15] *See* Cal. Pub. Util. Code § 399.16(c)(1).

[16] Cal. Pub. Util. Code § 399.16(b)(3).

[17] TRECs may be purchased from sources within the Western Electricity Coordinating Council (WECC) and are tracked by the Western Region Energy Generation Information System (WREGIS).

[18] *See* California Public Utilities Commission website, "Tradable Renewable Energy Credits," at: http://www.cpuc.ca.gov/PUC/energy/Renewables/hot/TRECs.htm (last visited April 6, 2011).

[19] *See* Cal. Pub. Util. Code § 399.16(c)(2).

[20] *See* Cal. Pub. Util. Code § 399.16(b)(2). Firmed and shaped renewable energy resource electricity products provide incremental electricity and are scheduled into a California balancing authority. *Id*.

[21] *See* California Public Utilities Commission, Legislative Memo: SB 14 (Simitian) (April 7, 2009), p. 3, at: ftp://ftp.cpuc.ca.gov/OGA/2010%20position%20letters/CPUC01-%23379534-v1-SB_14_Leg_Memo_(8437)_4_16_mtg.pdf; *see also* California Senate Energy, Utilities, And Communications Committee, Bill Analysis: AB 64, Comment No. 10, June 23, 2009, at: http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_0051-0100/ab_64_cfa_20090629_161423_sen_comm.html.

[22] *See* Cal. Pub. Util. Code § 399.16(c)(3).

[23] *See* Decision Resolving Petitions for Modification of Decision 10-03-021 Authorizing Use of Renewable Energy Credits for Compliance with the California Renewables Portfolio Standard and Lifting Stay and Moratorium Imposed by Decision 10-05-018, Cal.P.U.C., Ruling 06-02-012 (January 13, 2011), available at http://docs.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/129517.htm.

[24] *See* Latham & Watkins *Client Alert*, February 23, 2009, *Expediting the Deployment Of Renewable Energy Projects in California*, available at: http://www.lw.com/upload/pubContent/_pdf/pub2505_1.pdf.

[25] POU compliance with the RPS is enforced by the California Energy Commission and the California Air Resources Board. *See* Cal. Pub. Util. Code § 399.30(o). All non-POU sellers fall under the enforcement jurisdiction of the CPUC. *See* Cal. Pub. Util. Code § 399.15.

[26] *See* Cal. Pub. Util. Code § 399.15(b)(8) ("If a retail seller fails to procure sufficient eligible renewable energy resources to comply with a procurement requirement…and fails to obtain an order from the commission waiving enforcement…the commission shall exercise its authority pursuant to [Cal. Pub. Util. Code] Section 2113"). Under Cal. Pub. Util. Code § 2113, the California Public Utilities Commission is authorized to hold in contempt any "public utility, corporation, or person which fails to comply with any part of any order, decision, rule, regulation, direction, demand, or requirement of the commission" and to punish the violator to the same extent that contempt is punished by courts of record.

[27] *See* Cal. Pub. Util. Code § 399.14(a)(2)(C), *repealed and replaced by* SBX1 2 (Cal. 2011).

[28] *See* Cal. Pub. Util. Code § 399.15(b)(5).

[29] *See* Cal. Pub. Util. Code § 399.15(b)(7).

[30] *See* Cal. Pub. Util. Code § 399.16(e).

[31] *Id*.

[32] *See* Cal. Pub. Util. Code § 399.14(a)(2).

[33] *See, e.g.*, Latham & Watkins *Client Alert*, February 23, 2009, *Expediting the Deployment Of Renewable Energy Projects in California*, available at: http://www.lw.com/upload/pubContent/_pdf/pub2505_1.pdf.

[34] *See id*.

[35] Cal. Fish & Game Code § 705.

[36] Governor Schwarzenegger, Executive Order S-21-09 (September 15, 2009), at: http://gov38.ca.gov/index.php?/executive-order/13269/. The California Air Resources Board acted pursuant to its authority under the California Global Warming Solutions Act of 2006. See id.

[37] See CARB News Release: California Commits to More Clean, Green Energy (September 23, 2010), at: http://www.arb.ca.gov/newsrel/newsrelease.php?id=155; *see also* proposed 17 Cal. Code Regs. § 97004(a), at: http://www.arb.ca.gov/regact/2010/res2010/res10a.pdf (last visited April 6, 2011).

[38] *See* Latham & Watkins *Client Alert*, September 23, 2009, available at: http://www.lw.com/upload/pubContent/_pdf/pub2824_1.pdf.

[39] Although Senate Bill 2 does not explicitly repeal the Renewable Electricity Standard, the new statute appears to "serve the same purpose" as the existing regulations. *See* Cal. Gov. Code § 11349(f). Under Cal. Gov. Code § 11349 *et seq.*, where a regulation serves the same purpose as an existing statute, the regulation may be reviewed for "nonduplication" by the Office of Administrative Law. The Office of Administrative Law may then order the regulation's implementing agency to show cause why the regulation should not be repealed and may then order the repeal of the regulation over the agency's objection, subject to judicial review. *See* Cal. Gov. Code § 11349.8. Until the Renewable Electricity Standard is preempted or repealed, the provisions of the Renewable Electricity Standard remain in effect; however, where the Renewable Electricity Standard and the new RPS conflict, the new RPS controls. *See* Cal. Gov. Code § 11342.1.

[40] *See* Cal. Pub. Res. Code § 21080. *See also* C.P.U.C., "Transmission Siting and Environmental Permitting," available at: http://www.cpuc.ca.gov/PUC/energy/Environment/ (last visited April 20, 2011).

[41] *Id*.

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

David B. Amerikaner
+1.213.891.8057
david.amerikaner@lw.com
Los Angeles

Marc T. Campopiano
+1.714.755.2204
marc.campopiano@lw.com
Orange County

Laura A. Godfrey
+1.619.238.3060
laura.godfrey@lw.com
San Diego

David A. Goldberg
+1.213.891.8790
david.goldberg@lw.com
Los Angeles

Jared W. Johnson
+1.415.646.8305
jared.johnson@lw.com
San Francisco

David B. Rogers
+1.213.891.8236
david.rogers@lw.com
Los Angeles

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult. A complete list of our *Client Alerts* can be found on our website at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, please visit www.lw.com/LathamMail.aspx to subscribe to our global client mailings program.

Abu Dhabi
Barcelona
Beijing
Boston
Brussels
Chicago
Doha
Dubai
Frankfurt
Hamburg
Hong Kong
Houston
London
Los Angeles
Madrid
Milan
Moscow
Munich
New Jersey
New York
Orange County
Paris
Riyadh*
Rome
San Diego
San Francisco
Shanghai
Silicon Valley
Singapore
Tokyo
Washington, D.C.

* In association with the Law Office of Mohammed A. Al-Sheikh