

Client Alert

Latham & Watkins Environment, Land &
Resources Department

Governor Schwarzenegger Issues Executive Order to Increase California's Renewables Portfolio Standard After Threatening to Veto Similar Legislation

California's existing Renewables Portfolio Standard (RPS) is one of the most ambitious in the United States, requiring retail sellers of electricity to procure 20 percent of their electricity from eligible renewable energy resources by 2010. Efforts to spur further renewable generation and slash greenhouse gas emissions have led the California Air Resources Board (CARB),¹ among others,² to call for raising the RPS to 33 percent by 2020.

At the 11th hour of its recent legislative session, the California Legislature passed two bills that would do just that. Senate Bill (SB) 14³ and Assembly Bill (AB) 64⁴ (collectively, the RPS bills) would raise the RPS to 33 percent by 2020 and advance numerous other provisions that could significantly affect how energy is sited, generated, bought and sold in California and the western states.

The day after the RPS bills were passed, however, Governor Schwarzenegger announced he would veto the RPS bills over concerns about restricting the eligibility of out-of-state renewable energy resources and instead would use his executive powers to raise the RPS.⁵ Although the Governor has not vetoed the RPS bills as of the publication date of this *Alert*, we anticipate that the veto will occur. At this time, there does

not appear to be adequate legislative support to overcome a veto.

The Governor's objections to the RPS bills focus on the following restrictions:

The RPS bills would have modified renewable energy "delivery" requirements to limit substantially the eligibility of out-of-state solar and wind projects.

- The RPS bills would restrict how out-of-state intermittent resources such as wind and solar could be "firmed" and "shaped" with traditional energy resources.⁶ Firming and shaping involves combining energy schedules from a renewable energy resource with a non-intermittent, traditional energy resource to account for the intermittent nature of wind and solar generation and facilitate the firm delivery of energy into California. As described by the California Public Utilities Commission (CPUC), out-of-state wind or solar energy must be firmed and shaped to make it marketable to a California retail energy provider.⁸ By adopting strict "deliverability" requirements for out-of-state resources that are not directly interconnected with a transmission provider in California, the RPS bills would have restricted the eligibility of most out-of-state solar and wind

"If California's RPS is raised to 33 percent by 2020 and the Executive Order's directive is ultimately binding, it will significantly affect how energy is sited, generated, bought and sold in California and the Western states."

resources and would have limited transactions that only involved tradable Renewable Energy Credits (RECs), as described below.

The RPS bills would have limited the use of "tradable" RECs or "RECs-only" transactions to satisfy RPS requirements.

- RECs are certificates that represent the environmental attributes of renewable energy generation that can be traded or sold separately from the underlying energy deliveries. Tradable RECs can be associated with renewable energy that is never actually delivered to California. Under existing California law, there are no specified limits on the use of tradable RECs (although an initial annual 5 percent limitation for the three large investor-owned utilities' procurement had been included in a CPUC Proposed Decision issued by Administrative Law Judge Simon).⁹ The RPS bills would have capped the use of tradable RECs at 25 percent to 30 percent of a retail seller's total RPS requirement.¹⁰

On September 15, 2009, the Governor issued Executive Order S-21-09¹¹ requiring CARB to adopt regulations by July 31, 2010 to meet the 33 percent RPS by 2020 target.¹²

Key mandates of the Executive Order include:¹³

- CARB, under its AB 32 authority, must adopt a regulation consistent with the 33 percent renewable energy target by July 31, 2010. In developing the regulation, CARB 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.
- CARB, with respect to the new RPS implementation and in consultation with the CPUC and California Energy Commission (CEC), must regulate all California load-serving entities, including investor-owned utilities,

publicly owned utilities, direct access providers and community choice aggregators.

- CARB may delegate to the CPUC and the CEC any policy development or program implementation responsibilities that would reduce duplication and improve consistency with other energy programs.
- CARB must 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 (*i.e.*, not just within California).

Compared to the complexity and detail contained in the RPS bills, the Executive Order's key feature is its brevity. The Executive Order vests substantial discretion with CARB to develop the RPS regulations. CARB is given wide flexibility to "increase the target and accelerate and expand the time frame" and to delegate "any policy development or program implementation responsibilities" to the CPUC or CEC for implementation. Only parameters such as providing "the greatest environmental benefits with the least environmental costs and impacts" and a specific directive to include resources "throughout the Western Interconnection" appear to limit CARB's discretion.

Governor Schwarzenegger's Executive Order sends a strong signal that the state executive branch seeks to facilitate California utilities' ability to meet the state's ambitious 33 percent goal through at least partial reliance on out-of-state generation. And, by designating CARB as the agency for implementing the 33 percent standard, the Executive Order also marks a significant administrative shift in which

that state agency will take the lead on key features of RPS implementation.

We anticipate that CARB's regulations will contain some or all of the following RPS features, which were previously endorsed by the Governor:¹⁴

- Allow approximately 30 percent of RPS requirements to be satisfied with tradable RECs, and provide the CPUC with authority to raise this limit as appropriate.
- Provide for flexible "delivery" requirements for out-of-state renewable energy resources, which allows for delivery to occur via "firming and shaping" of intermittent resources paired with traditional energy resources.
- Explore opportunities to expand the eligibility of other renewable energy resources.
- Establish market valuation cost controls to protect ratepayers.
- Eliminate annual interim performance targets for RPS compliance.

The lack of parameters limiting CARB's discretion may increase uncertainty associated with the RPS program in the absence of new legislation. Although CARB's regulations are mandated to be in place by July 31, 2010,¹⁵ legal challenges could bring further delays and uncertainty. Given current shortfalls in meeting the existing RPS, ambiguity over the scope and content of the RPS requirements may jeopardize eventual compliance. In addition, the Executive Order and potential legal challenges raise the question of whether the CPUC will continue to postpone its REC proceeding (and any action on Administrative Law Judge Simon's March 27, 2009 Proposed Decision). Consequently, it remains uncertain whether and the extent to which the CPUC will act on any REC-related transactions involving California investor owned utilities until CARB's regulations become effective.

Critics have questioned the legality of the Executive Order and whether it would be binding once the Governor leaves office.¹⁶ AB 32 does not expressly provide the authority to raise the RPS standard or apply it to publicly owned utilities. Nonetheless, AB 32 gives CARB broad powers to adopt and enforce regulations to reduce greenhouse gas emissions, including emissions from the energy sector. It is unclear, however, whether CARB's authority is so expansive under AB 32 that it can intrude upon the authority of the CPUC and CEC, which traditionally have regulated the energy sector, and recast a regulatory scheme as complex and widespread as the RPS program. Ultimately, this issue may be resolved in court.

Implementation of any RPS mandate, whether via the Executive Order or legislation, will pose substantial challenges to California's infrastructure and economy. To issue some legal mandate requiring renewable energy usage is simple, but actually achieving sufficient renewable generation supported by an adequate transmission infrastructure will be much more challenging. A recent CPUC report highlights the myriad technical, economical and political challenges — many of which are outside the control of California decision-makers — impeding implementation of a 33 percent RPS by 2020 mandate.¹⁷ According to the CPUC, the "magnitude of the infrastructure that California will have to plan, permit, procure, develop and integrate in the next ten years is immense and unprecedented."¹⁸ As a result, it remains to be seen whether and the extent to which California is able to develop and finance the infrastructure required to achieve this mandate.

In summary, if California's RPS is raised to 33 percent by 2020 and the Executive Order's directive is ultimately binding, it will significantly affect how energy is sited, generated, bought and sold in California and the Western states.

Given the Governor's threatened veto of the RPS bills, questions over the legality of Executive Order S-21-09, and uncertainty over the eventual scope of CARB's RPS regulations, we expect a rapidly shifting regulatory and legal landscape for the RPS program and renewable energy projects. We will track these issues and are available to advise clients accordingly.

Endnotes

- ¹ CARB, Proposed Scoping Plan at p. 17, Table 2, and p. 46.
- ² See Governor Schwarzenegger, Executive Order, S-14-08 (July 17, 2009).
- ³ Senate Bill (SB) 14 (Simitian/Kehoe/Padilla/Steinberg) (Ca. 2008), passed on September 11, 2009, available at: http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_0051-0100/ab_64_bill_20090911_amended_sen_v92.html.
- ⁴ Assembly Bill (AB) 64 (Krekorian/Bass) (Ca. 2008), passed on September 11, 2009, available at: http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb_0001-0050/sb_14_bill_20090915_enrolled.html.
- ⁵ See, e.g., *Los Angeles Times*, "Schwarzenegger may order a change in green energy rules," Marc Lifsher, September 14, 2009 available at <http://www.latimes.com/business/la-fi-power14-2009sep14,0,1839476.story>.
- ⁶ SB 14, *supra*, § 5.
- ⁷ Examples of firming and shaping transactions were provided by the California Energy Commission's (CEC) "*Eligibility Guidebook*." See Renewables Portfolio Standard Eligibility Guidebook, CEC-300-2007-006-ED3-CMF, at 23-24 (2008), available at <http://www.energy.ca.gov/renewables/documents/index.html#rps>.
- ⁸ See CALIFORNIA PUBLIC UTILITIES COMMISSION, Bill Analysis: SB 14 (Simitian) (April 7, 2009), p. 3; see also CALIFORNIA SENATE ENERGY, UTILITIES, AND COMMUNICATIONS COMMITTEE, Bill Analysis: AB 64, Comment No. 10, June 23, 2009.
- ⁹ Proposed Decision Authorizing the Use of Renewable Energy Credits for Compliance with California Renewables Portfolio Standard, Rulemaking 06-02-012, at 28 (Cal. P.U.C. Mar. 27, 2009), available at <http://docs.cpuc.ca.gov/efile/PD/99016.pdf>. As of the date of the publication of this *Client Alert*, the CPUC has postponed ruling on the Proposed Decision, and it is not currently effective.

¹⁰ SB 14, *supra*, § 9.

¹¹ Governor Schwarzenegger, Executive Order S-21-09, September 15, 2009, available at: <http://gov.ca.gov/executive-order/13269/>

¹² Governor Schwarzenegger, Executive Order S-21-09 on September 15, 2009, § 1.

¹³ See Governor Schwarzenegger, Executive Order S-21-09 on September 15, 2009, §§ 1 - 5.

¹⁴ See GOVERNOR ARNOLD SCHWARZENEGGER, Letter to the Honorable Steinberg, Hollingsworth, Bass, and Villines, May 22, 2009 (Schwarzenegger Letter).

¹⁵ *Id.*, § 1.

¹⁶ See *Los Angeles Times*, "Schwarzenegger orders more renewable energy — his way," Marc Lifsher, September 16, 2009 available at <http://www.latimes.com/business/la-fi-power16-2009sep16,0,3412344.story>.

¹⁷ CPUC, "33 percent Renewables Portfolio Standard Implementation Analysis—Preliminary Results," June 2009.

¹⁸ *Id.*, p. 4.

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