

# Client Alert

Latham & Watkins Environment, Land &  
Resources Department

## California's Cap and Trade Regulation and Renewables Portfolio Standard: Two Significant Regulatory Programs Affecting California's Electricity Sector

### Introduction

California is poised to implement two programs that will have significant ramifications for electricity generation, energy markets, transmission line development, and other greenhouse gas-emitting activities in California and throughout the western states: (1) the California Air Resources Board (CARB) greenhouse gas (GHG) cap and trade program pursuant to the California Global Warming Solutions Act of 2006, commonly referred to as AB 32, and (2) an increased Renewables Portfolio Standard (RPS) that will require regulated utilities to obtain 33 percent of their energy supplies from eligible renewable energy resources.

Although both the proposed cap and trade program and the RPS share a goal of reducing GHG emissions, the programs operate via distinct mechanisms and have different requirements, and compliance with one program generally does not bear upon compliance with the other. This alert considers the effects of these two programs on the electricity sector by providing:

- An overview of the cap and trade program, including recent

amendments released by CARB on September 12, 2011, with a focus on the electricity sector requirements

- A summary of relevant portions of the RPS
- "Questions and Answers" about how the electricity sector may be affected by different requirements in these two programs, including where there may be regulatory overlap

### Overview of California's Cap and Trade Regulations and Their Impact Upon the Electricity Sector

AB 32 requires California to reduce GHG emissions to 1990 levels by 2020.<sup>1</sup> CARB, which has responsibility for implementing AB 32, approved a GHG cap and trade program in December 2010 and simultaneously advised its staff that the regulation would need to be modified.<sup>2</sup> CARB released proposed changes to the cap and trade regulation on July 25, 2011, and September 12, 2011. The July 25 draft provoked a multitude of comments from stakeholders, and September 27, 2011 is the deadline to submit to CARB comments on the September 12 draft.

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**Overview of the Cap and Trade Program (as proposed on September 12, 2011)**

The idea behind the cap and trade program is that aggregate annual emissions of GHGs from certain sectors of the economy will be capped starting in 2013, and this cap will be reduced over time.<sup>3</sup> The cap will be enforced through the requirement that emitters of GHGs in capped sectors obtain compliance instruments—either allowances or offsets<sup>4</sup>—in amounts equal to their respective emissions of GHGs.<sup>5</sup>

An allowance is an authorization allowing a covered entity to emit one metric ton of carbon dioxide equivalent (CO<sub>2</sub>e).<sup>6</sup> CARB is to create allowances in amounts equaling the aggregate annual GHG emission caps and then allocate the allowances, auctioning some and distributing others at no cost to covered entities.<sup>7</sup> Trading of the allowances will generally be allowed (but subject to a number of restrictions) such that an entity holding more allowances than

it needs to cover its own compliance obligation will be able to sell the excess allowances to a different entity that would otherwise lack sufficient compliance instruments to cover its compliance obligation.<sup>8</sup> The regulations also allow an entity to satisfy up to eight percent of its compliance obligation through obtaining offsets, which are verified reductions of GHG emissions in addition to those required of the capped sectors or under other mandatory programs, such as certain emissions reductions in the forestry or agricultural sectors.<sup>9</sup>

**Annual GHG Allowance Budgets**

The cap and trade regulations set a cap on GHG emissions in the form of annual GHG allowance budgets, which limit the number of allowances to emit GHGs that CARB is to create for each year.<sup>10</sup> The annual GHG allowance budgets specified under the cap and trade regulations are set forth below:

<b>California GHG Allowance Budgets<sup>11</sup></b>		
	Budget Year	Annual Allowance Budget (in millions of CA GHG Allowances)
First Compliance Period	2013	162.8
	2014	159.7
	2015	394.5
Second Compliance Period	2016	382.4
	2017	370.4
	2018	358.3
Third Compliance Period	2019	346.3
	2020	334.2

**Covered Sectors, Emissions Thresholds, and Timing of Cap**

The cap is to be imposed upon certain sectors of the economy starting in 2013 and others beginning in 2015 (which is why the annual GHG allowance budget actually increases from 2014 to 2015, as depicted in the table above).<sup>12</sup> The sectors covered by the proposed cap and trade regulations, the emissions thresholds which trigger applicability of the regulations (and generally serve to exclude entities associated with emissions of less than 25,000 metric tons of CO<sub>2</sub>e/year), and the year when compliance obligations begin are summarized below:

Entities Covered by Cap and Trade Regulations <sup>13</sup>		Emissions Thresholds which Incur Compliance Obligation <sup>14</sup>	Year When Compliance Obligation Begins <sup>15</sup>
First deliverers of electricity:	Electricity generating facilities	25,000 metric tons CO <sub>2</sub> e/year (from electricity generating facility)	2013
	Electricity importers	<ul style="list-style-type: none"> <li>• Unspecified Sources: all emissions associated with imports from unspecified sources</li> <li>• Specified Sources: <ul style="list-style-type: none"> <li>◦ Prior to January 1, 2015: all emissions associated with any specified source of electricity which emits 25,000 metric tons CO<sub>2</sub>e/year (even if the emissions associated with the portion of electricity imported are less than 25,000 metric tons CO<sub>2</sub>e/year)</li> <li>◦ After January 1, 2015: all emissions associated with any specified source of electricity (no matter how small)</li> </ul> </li> </ul>	2013
Certain GHG-emitting operations: <ul style="list-style-type: none"> <li>• Cement production</li> <li>• Cogeneration</li> <li>• Glass production</li> <li>• Hydrogen production</li> <li>• Iron and steel production</li> <li>• Lime manufacturing</li> <li>• Nitric acid production</li> <li>• Petroleum and natural gas systems</li> <li>• Petroleum refining</li> <li>• Pulp and paper manufacturing</li> <li>• Self-generation of electricity</li> <li>• Stationary combustion sources</li> </ul>		25,000 metric tons CO <sub>2</sub> e/year (including process, stationary combustion, and vented emissions)	2013
Carbon dioxide suppliers		25,000 metric tons CO <sub>2</sub> e/year (as a result of (a) capture from production processes, (b) capture for geologic sequestration, or (c) extraction or production from wells)	2013
Suppliers of natural gas (including public utility gas corporations, publicly-owned natural gas utilities, and intrastate pipelines)		25,000 metric tons CO <sub>2</sub> e/year (as calculated by assuming full combustion or oxidation of the imported/delivered fuels)	2015
Suppliers of reformulated gasoline blendstock for oxygen blending distillate fuel oil, or liquefied petroleum gas		25,000 metric tons CO <sub>2</sub> e/year (as calculated by assuming full combustion or oxidation of the imported/delivered fuels)	2015

**Allowance Disposition**

CARB has the authority and the obligation to create allowances in amounts equal to the annual allowance budgets, and the cap and trade regulation describes how CARB is to dispose of these allowances.<sup>16</sup> The specific manner in which CARB is then required to dispose of the allowances it creates is summarized below:

<b>Allowance Disposition</b>	
<b>Method and Quantity of Allocation/Auction<sup>17</sup></b>	<b>Intent of and Notes Concerning Allocation Method</b>
<p><i>Allowance Price Containment Reserve:</i></p> <ul style="list-style-type: none"> <li>• 1 percent of the allowances from budget years 2013-2014</li> <li>• 4 percent of the allowances from budget years 2015-2017</li> <li>• 7 percent of the allowances from budget years 2018-2020</li> </ul>	<p>The intent of the Allowance Price Containment Reserve is to prevent a scenario where allowances are unavailable to covered entities.<sup>18</sup></p> <p>Allowances deposited in the Allowance Price Containment Reserve will be, starting in 2013, auctioned six weeks following each quarterly allowance auction.<sup>19</sup></p>
<p><i>Voluntary Renewable Electricity Reserve Account:</i></p> <ul style="list-style-type: none"> <li>• 0.5 percent of the allowances from budget years 2013-2014</li> <li>• 0.25 percent of the allowances from budget years 2015-2020</li> </ul>	<p>The Voluntary Renewable Electricity Reserve Account is intended to hold allowances that can be retired to account for voluntary renewable electricity.<sup>20</sup></p>
<p><i>Allocation to Electrical Distribution Utilities:</i></p> <ul style="list-style-type: none"> <li>• 95.8 million of the allowances from budget year 2013 distributed at no cost to electrical distribution utilities</li> <li>• Decreases annually so that 83.1 million of the allowances from budget year 2020 distributed to electrical distribution utilities</li> </ul>	<p>Electrical distribution utilities are required to use these allowances exclusively for the benefit of retail ratepayers.<sup>21</sup></p>
<p><i>Allocation to Industrial Covered Entities:</i></p> <ul style="list-style-type: none"> <li>• Available allowances will be allocated at no cost to entities in certain industrial sectors using a "product output-based benchmarking methodology"</li> </ul>	<p>Allocations are to be made to entities engaged in certain industrial activities based on the risk of leakage associated with the activities.<sup>22</sup></p> <p>The regulations set targets for providing allowances on a sector by sector basis and contemplate that entities in certain industrial sectors will be allocated allowances at no cost in amounts sufficient to cover anywhere between thirty and one hundred percent of their expected compliance obligations (with the rule being the greater the risk of leakage associated with a sector, the higher the target allocation).<sup>23</sup> However, the possibility exists that not enough allowances will exist under the cap to provide to industrial covered entities the full target allocations contemplated by the regulations.<sup>24</sup></p>

<b>Allowance Disposition (continued)</b>	
<b>Method and Quantity of Allocation/Auction<sup>17</sup></b>	<b>Intent of and Notes Concerning Allocation Method</b>
Auction and Advance Auction: <ul style="list-style-type: none"> <li>• Advance Auction: 10 percent of the allowances from budget years 2015-2020 will be auctioned three years in advance of each respective budget year.</li> <li>• Auction: Any allowance not disposed of via the routes above will be auctioned during the budget year matching the vintage of the allowance.</li> </ul>	Proceeds from the auction and advance auction of allowances will be deposited into the Air Pollution Control Fund. <sup>25</sup>

The cap and trade regulations provide for the auction and advance auction of certain allowances at regularly-scheduled auctions. In addition, the regulations require that certain allowances distributed to electrical distribution utilities, for the benefit of their ratepayers, be monetized at these auctions. Finally, the regulations provide for reserve auctions, to take place shortly after the regularly-scheduled auctions. The auctions provide an opportunity for covered entities to purchase allowances to apply towards their compliance obligations. These auctions are described in more detail below:

<b>Allowance Auctions<sup>26</sup></b>					
<b>Budget Year</b>	<b>Timing</b>	<b>What's for Sale?</b>			
		<b>Auction (the three kinds of allowances described below are auctioned together)</b>			<b>Advance Auction (advance auctions are conducted on the same days as, but separately from, the "regular" auctions described to the left)</b>
		Allowances of same vintage as budget year:	Allowances issued to electrical distribution utilities and consigned for auction:	Allowances which went unsold in previous auctions:	Advance auction of allowances of vintage future to budget year:
2012	August 15 and November 14	None	Each IOU must offer 1/6th of the allowances directly allocated to it in 2012 for sale at each of the two auctions scheduled for 2012.	None	10 percent of allowances from budget year 2015 to be evenly distributed in two auctions

Allowance Auctions <sup>19</sup> (continued)					
Budget Year	Timing	What's for Sale?			
		Auction (the three kinds of allowances described below are auctioned together)			Advance Auction (advance auctions are conducted on the same days as, but separately from, the "regular" auctions described to the left)
		Allowances of same vintage as budget year:	Allowances issued to electrical distribution utilities and consigned for auction:	Allowances which went unsold in previous auctions:	Advance auction of allowances of vintage future to budget year:
2013	Quarterly: • February • May • August • November of each year	Each of the four auctions will offer one quarter of any current calendar year allowances not disposed of via the other allowance allocations paths (Allowance Price Containment Reserve, Voluntary Renewable Electricity Reserve Account, Allocation to Electrical Distribution Utilities, Allocation to Industrial Covered Entities, Advance Auction).	Each electrical distribution utility must offer for sale at auction all allowances in a limited use holding account (which is where an IOU, but not a POU, must receive all of its directly allocated allowances <sup>27</sup> ) which are from budget years current or prior to the then-current calendar year.	Allowances designated for an auction but which remain unsold when the auction settlement price equals the Auction Reserve Price are returned to the Auction Holding Account to be auctioned after two consecutive auctions result in an auction settlement price greater than the applicable Auction Reserve Price.	10 percent of allowances from budget year 2016 to be evenly distributed in the four auctions
2014					10 percent of allowances from budget year 2017 to be evenly distributed in the four auctions
2015					10 percent of allowances from budget year 2018 to be evenly distributed in the four auctions
		<i>Allowance Price Containment Reserve Auctions:</i> In addition to the auctions described above, the cap and trade regulations provide for Allowance Price Containment Reserve auctions. These latter auctions, of all allowances then-currently in the reserve, are to take place starting in March 2013, and then six weeks after each quarterly allowance auction. <sup>28</sup>			

## Requirements Specific to Electricity Sector

First deliverers of electricity face a compliance obligation for — and must obtain allowances offsets to cover — the CO<sub>2</sub>e emissions associated with the electricity they generate in or import to California.<sup>29</sup>

### Calculating the Compliance Obligation

An operator of an electricity generating facility in California faces a compliance obligation equal to all emissions reported and verified or assigned pursuant to CARB's Regulation for the Mandatory Reporting of Greenhouse Gas Emissions (MRR) unless any of those emissions are specifically exempted from a compliance obligation under the cap and trade regulation.<sup>30</sup>

Calculating the compliance obligation for an electricity importer is trickier. To do so, the importer must first sum emissions associated with imports from "unspecified sources" and "specified and covered" sources. Next, the importer is to subtract from that sum any (i) emissions subject to an "RPS adjustment," (ii) emissions from qualified exports, and (iii) emissions with a first point of receipt located in a linked jurisdiction.<sup>31</sup>

As to the summing of emissions associated with electricity imports, the cap and trade regulations and the MRR distinguish between "specified sources" and "unspecified sources" of electricity, the latter of which are subject to the default emission factor (of 0.428 MT of CO<sub>2</sub>e/MWh). Imports from specified sources — sources in which the importer has an ownership interest or with which the importer has a written power contract as defined in the MRR<sup>32</sup> — are eligible for a source-specific emission factor which is lower than the default emission factor.<sup>33</sup> To be eligible for an emission factor lower than the default factor, however, imported electricity must not only come from a specified source, but any Renewable Energy

Credits (RECs) associated with the electricity must be retired and verified pursuant to the MRR.<sup>34</sup> Finally, imported electricity can only be assigned an emission factor lower than the default emission factor if the electricity is "directly delivered," meaning that it satisfies at least one of the following four criteria:

- The facility has a first point of interconnection with a California balancing authority
- The facility has a first point of interconnection with distribution facilities used to serve end users within a California balancing authority area
- The electricity is scheduled for delivery from the specified source into a California balancing authority via a continuous transmission path from interconnection of the facility in the balancing authority in which the facility is located to a final point of delivery located in the state of California
- There is an agreement to dynamically transfer electricity from the facility to a California balancing authority<sup>35</sup>

One final point to take into account when summing the emissions associated with electricity imports is that certain emissions are specifically exempted from a compliance obligation under the cap and trade regulation (or, in other words, are not from "covered" sources), and these emissions are not tallied when calculating a compliance obligation — even if they are from specified sources.<sup>36</sup> Summing up emissions associated with electricity both from (i) specified sources which are covered by the cap and trade regulations and from (ii) unspecified sources completes the first step of calculating an electricity importer's compliance obligation.

The second step to calculating an electricity importer's compliance obligation is subtracting from the sum described above any (i) emissions from qualified exports, (ii) emissions with a

first point of receipt located in a linked jurisdiction, and (iii) emissions subject to an "RPS adjustment." Qualified exports are defined as "electricity that is exported in the same hour as imported electricity and documented by NERC E-tags. When imports are not documented on NERC E-tags, because a facility or unit located outside the state of California has a first point of interconnection with a California balancing authority area, the reporting entity may demonstrate hourly electricity delivery consistent with the record keeping requirements of the California balancing authority area, including records of revenue quality meter data, invoices, or settlements data. Only electricity exported within the same hour and by the same importer as the imported electricity is a qualified export. It is not necessary for the imported and exported electricity to enter or leave California at the same intertie. Qualified exports shall not result in a negative compliance obligation for any hour."<sup>37</sup> Second, any emissions associated with electricity with a first point of receipt located in a jurisdiction (such as another state or a Canadian province) which is linked to California's cap and trade system can be subtracted from an importer's compliance obligation.<sup>38</sup> Finally, an "RPS adjustment" to an importer's compliance obligation may be made for electricity which satisfies all of the following criteria:

- The importer has either (i) ownership or contract rights to procure the electricity generated by the eligible renewable energy resource or (ii) a contract to import electricity on behalf of a California entity that has ownership or contract rights to the electricity generated by the eligible renewable energy resource
- The RECs associated with the electricity claimed for the RPS adjustment are used to comply with California RPS requirements during the same year in which the RPS adjustment is claimed

- The electricity is *not* directly delivered
- The electricity is *not* generated in a jurisdiction with a GHG emissions trading system which is linked to California's<sup>39</sup>

As the RPS adjustment is limited to electricity which is not directly delivered, the RPS adjustment cannot be claimed for any imports from specified sources (which must be directly delivered). The RPS adjustment is calculated as the product of the default emission factor for unspecified sources multiplied by the amount of electricity that satisfies the RPS adjustment criteria set forth above.<sup>40</sup> The RPS adjustment provisions were newly-inserted into the cap and trade regulations with the intent of harmonizing the regulations with the RPS such that resources eligible for the RPS have no compliance obligation under the cap and trade regulations.<sup>41</sup>

Lastly, the proposed regulations aim to ensure accuracy in the calculation of compliance obligations by proscribing "resource shuffling," which they describe as a plan to receive credit for emissions reductions which have not actually occurred.<sup>42</sup>

#### **Direct Allocation of Allowances**

Electrical distribution utilities are eligible for direct allocation (that is, allocation without payment) of California GHG allowances if they have complied with the requirements of the MRR and have obtained a positive or qualified positive verification statement for their GHG emissions statement from the prior year.<sup>43</sup> However, any allowances directly allocated to electrical distribution utilities must be used only for the benefit of retail ratepayers.<sup>44</sup> Each IOU must offer 1/6th of the allowances directly allocated to it in 2012 for sale at each of the two auctions scheduled for 2012.<sup>45</sup> After 2012, each electrical distribution utility must offer for sale at auction all allowances it possesses in a limited use holding account (which is where an IOU, but not a POI must receive all

of its directly allocated allowances<sup>46</sup>) which are from budget years current or prior to the then-current calendar year.<sup>47</sup> Beginning in 2013, electrical distribution utilities must report annually to CARB on auction proceeds and allowance value.<sup>48</sup>

**Cap and Trade Regulation Comment Period Runs Until September 27, 2011**

Stakeholders have until September 27, 2011, to submit to CARB comments on the September 12 proposed cap and trade regulations. CARB received voluminous comments on almost every aspect of the July 25, 2011, version of the cap and trade regulations as they concerned the electricity sector, and CARB made updates to the regulations to account for many of these comments (such as those concerning resource shuffling, qualified exports, and the RPS adjustment/replacement electricity for renewables). The September 12 draft, however, does not address all of the concerns raised with respect to the July 25 draft.

CARB is scheduled to consider the proposed cap and trade regulation on October 20, 2011, and is currently planning to file the finalized regulation with the California Office of Administrative Law by October 28, 2011.

**Overview of California's Renewables Portfolio Standard**

On April 12, 2011, Governor Jerry Brown signed Senate Bill 2<sup>49</sup> to increase California's Renewables Portfolio Standard (RPS) to 33 percent by 2020, among the most aggressive renewable energy goals in the United States.<sup>50</sup> The RPS requires regulated sellers of electricity to procure 33 percent of their total energy supplies from certified renewable resources<sup>51</sup> according to the following schedule:

Compliance Period	RPS <sup>52</sup>
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

Under the RPS, there are two main components to the definition of renewable generation: (1) the electricity must be derived from a designated renewable resource, and (2) the electric generating facility must be certified by the California Energy Commission (CEC).

Eligible Renewable Energy Resources <sup>53</sup>
<ul style="list-style-type: none"> <li>• Biodiesel</li> <li>• Biogas (including pipeline biomethane)</li> <li>• Biomass</li> <li>• Conduit hydroelectric</li> <li>• Digester gas</li> <li>• Fuel cells using renewable fuels</li> <li>• Geothermal</li> <li>• Landfill gas</li> <li>• Municipal solid waste</li> <li>• Ocean wave, ocean thermal, and tidal current</li> <li>• Photovoltaic</li> <li>• Small hydroelectric (30 megawatts or less)</li> <li>• Solar thermal electric</li> <li>• Wind</li> <li>• Hydroelectric incremental generation from efficiency improvements</li> </ul>

Electricity cannot satisfy requirements under the RPS until the CEC certifies the generating facility as an RPS-eligible renewable energy resource based on guidelines established by the CEC.<sup>54</sup> "Pre-certification" is available for facilities that are not yet online or not yet using an eligible renewable resource.<sup>55</sup> Even if the CEC pre-certifies a facility, the facility must still submit an application and receive full certification once it is capable of generating RPS-eligible electricity.<sup>56</sup>

Senate Bill 2 represents a substantial new statutory requirement that will have significant ramifications for energy markets, electricity generation, and transmission line development in California and throughout the western states. The California Public Utilities Commission (CPUC) has estimated that the new 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.<sup>57</sup>

Originally enacted in 2002, California's RPS previously set a 20 percent by 2010 standard.<sup>58</sup> The RPS previously only 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.<sup>59</sup> Notably, the 2002 RPS did not cover Publicly Owned Utilities (POUs), such as the Los Angeles Department of Water & Power. However, 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.<sup>60</sup> Although many POUs have already been pursuing significant renewables procurement,<sup>61</sup> the inclusion of POUs is expected to increase demand for development of renewable resources in California and the western states.

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, 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:<sup>62</sup>

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,<sup>63</sup> 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,<sup>64</sup> or (2) have an agreement to dynamically transfer electricity<sup>65</sup> to a California balancing authority.<sup>66</sup> Senate Bill 2 mandates *minimum* allocation requirements for this type of renewable resource to satisfy the RPS:
  - At least 50% of their renewable energy supplies until December 31, 2013
  - At least 65% during the December 31, 2014 to December 31, 2016 compliance period
  - At least 75% thereafter<sup>67</sup>
2. Tradable Renewable Energy Credits (TREC)s<sup>68</sup> — TREC)s 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.<sup>69</sup> Senate Bill 2 sets *maximum* limits for using TREC)s:<sup>70</sup>
  - Up to 25% of RPS requirements until December 31, 2013
  - Up to 15% during the December 31, 2014 to December 31, 2016 compliance period
  - Up to 10% thereafter<sup>71</sup>
3. Out-of-State Firm and Shaped Renewable Resources<sup>72</sup> — 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”).<sup>73</sup>

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 Senate Bill 2, 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% (through December 31, 2013) and then 35% (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% in-state renewable resources (or out-of-state resources that fit narrow exceptions) and only up to 10% of compliance from TRECs. Even though the CPUC has discretion under certain defined circumstances to permit up to 35% of a utility’s renewable resources to come from outside California, 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.<sup>74</sup>

**Questions and Answers:**

**What Entities Are Regulated Under Each Program?**

Covered Entities	
Cap and Trade Program	RPS
<p><b>First deliverers of electricity:</b></p> <ul style="list-style-type: none"> <li>• Electricity generating facilities</li> <li>• Electricity importers</li> </ul> <p><b>Certain GHG-emitting operations:</b></p> <ul style="list-style-type: none"> <li>• Cement production</li> <li>• Cogeneration</li> <li>• Glass production</li> <li>• Hydrogen production</li> <li>• Iron and steel production</li> <li>• Lime manufacturing</li> <li>• Nitric acid production</li> <li>• Petroleum and natural gas systems</li> <li>• Petroleum refining</li> <li>• Pulp and paper manufacturing</li> <li>• Self-generation of electricity</li> <li>• Stationary combustion sources</li> </ul> <p><b>Carbon dioxide suppliers</b></p> <p><b>Suppliers of natural gas</b> (including public utility gas corporations, publicly-owned natural gas utilities, and intrastate pipelines)</p> <p><b>Suppliers of RBOB, distillate fuel oil, or liquefied petroleum gas</b></p>	<p><b>Investor-owned utilities</b> (e.g., Southern California Edison, Pacific Gas &amp; Electric, and San Diego Gas &amp; Electric)</p> <p><b>Publicly-owned utilities</b> (e.g., the Los Angeles Department of Water and Power and the Sacramento Metropolitan Utility District)</p> <p><b>Community choice aggregators</b><sup>75</sup></p> <p><b>Electric service providers</b><sup>76</sup></p>

### **Are Some Entities Regulated Under Both Programs?**

Yes, some, but not all, entities are regulated under both the cap and trade program and the RPS. Both programs regulate first deliverers of electricity, including POUs (e.g., the Los Angeles Department of Water and Power and the Sacramento Metropolitan Utility District) and IOUs (e.g., Southern California Edison, Pacific Gas & Electric, and San Diego Gas & Electric). The cap and trade regulations also impose obligations upon many entities outside of the electricity sector.

While the programs share a goal of reducing GHG emissions, the mechanisms by which they work are different. The RPS requires utilities and other entities to procure a certain percentage of their generation from renewable sources. The cap and trade program caps GHG emissions from certain sectors of the economy and requires first deliverers of electricity and other entities in capped sectors to obtain compliance instruments (such as allowances or offsets) in amounts equal to their respective GHG emissions.

### **Can Renewable Generation Satisfy Compliance Obligations Under Both Programs?**

No. Renewable electricity or renewable energy credits (RECs) used to satisfy RPS obligations cannot also satisfy GHG compliance obligations under the cap and trade program. An annual GHG allowance budget exists under the cap and trade program, which serves as a limitation upon the aggregate emissions from capped sectors. CARB creates a number of allowances, or permits to emit, equal to the emissions limit. Given the current structure of the program, renewable generation could not directly satisfy a compliance obligation without simultaneously increasing the cap.

Of course, if first deliverers of electricity reduce conventional generation by replacing it with lower GHG renewable generations, they will reduce their GHG

emissions and thereby reduce their compliance obligations. In this manner, switching to renewable generation from conventional generation may result in an entity having a smaller compliance obligation and needing to obtain fewer compliance instruments to meet its obligation.

In addition, electricity importers may claim an "RPS adjustment" to their respective compliance obligations for their imports to California of renewable energy from unspecified sources, provided the imports meet the following criteria:

- The importer has either (i) ownership or contract rights to procure the electricity generated by the eligible renewable energy resource or (ii) a contract to import electricity on behalf of a California entity that has ownership or contract rights to the electricity generated by the eligible renewable energy resource
- The RECs associated with the electricity claimed for the RPS adjustment are used to comply with California RPS requirements during the same year in which the RPS adjustment is claimed
- The electricity is not directly delivered
- The electricity is not generated in a jurisdiction with a GHG emissions trading system which is linked to California's<sup>77</sup>

This RPS adjustment provision was added with the intention of reducing or eliminating the compliance obligation associated with eligible renewable electricity which is imported to satisfy the RPS.<sup>78</sup>

### **How do the Programs Impact the Voluntary Renewable Electricity Market?**

CARB's proposed cap and trade regulations contain new provisions pertaining to "voluntary renewable electricity," which is defined under the regulations as electricity (or renewable energy credits) which has

not and will not be sold or used to meet any mandatory requirements (such as California's RPS) either in California or elsewhere.<sup>79</sup> The idea behind these provisions is that, once the GHG emissions cap is in place, voluntary renewable electricity will only reduce GHG emissions if the voluntary renewable electricity is tied to a reduction in the total amount of allowances available under the cap and trade program.

The regulations provide for a "voluntary renewable electricity reserve account" to be set up to hold allowances which are retired so that the electricity or RECs associated with the electricity will qualify as voluntary renewable electricity.<sup>80</sup> In order to retire allowances associated with an energy product, the end user of the energy product (or an entity acting on behalf of the end user, or a "voluntary renewable electricity participant" (defined to include a voluntary renewable electricity generators and REC marketers)) must satisfy all of the following criteria:

- The renewable generating facility must be from a facility that either (i) has been certified by the CEC as *eligible* for the RPS or (ii) satisfies the design and installation standards set out in the California Energy Commission's Guidelines for California's Solar Electric Incentive Programs ("Solar Guidelines")
- Generation must be new and not have served load prior to July 1, 2005
- Renewable electricity (or the renewable electricity associated with RECs) must be "delivered directly"<sup>81</sup> to California
- Request allowance retirement by July 1 of the year following the year during which the electricity was generated or the RECs were purchased
- Attest that electricity or RECs for which retirement of allowances is sought have not been sold or used to meet any mandatory requirements (such as California's RPS) either in California or elsewhere<sup>82</sup>

The current provisions place restrictions on "voluntary renewable electricity" that could limit the supply and exclude sources some view as renewable energy (which could potentially impact the voluntary market if buyers will only accept renewables certified by CARB as voluntary renewable electricity). Notably, the limitation that only RPS-eligible electricity (or electricity satisfying the Solar Guidelines) can count as voluntary renewable generation under the cap and trade program serves to exclude certain low-GHG generation, such as nuclear, from being certified as voluntary renewable electricity. In addition, as the voluntary renewable electricity reserve account is to contain only a limited number of allowances, exhaustion of the account could serve as a ceiling on the voluntary market.

### **Does Renewable Electricity Have to Be Generated In California?**

No, renewable generation does not have to be located in California to qualify for the RPS, but restrictions apply. The CEC certification process requires additional data and analysis for renewable energy facilities located outside of California and/or the United States. In addition, with the passage of Senate Bill 2, over the long term, no more than 25 percent of RPS compliance can be satisfied from electricity generated outside of California. While the CPUC has discretion under certain 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. These long-term restrictions on 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.<sup>83</sup>

Importers of electricity face a compliance obligation under the cap

and trade regulations in an amount equal to the emissions associated with their imports.

### **Can “Multi-Fuel” Facilities Count As Renewable?**

Yes, in some circumstances. The CEC has established procedures for certifying “multi-fuel” facilities that use both renewable and non-renewable fuel inputs (*e.g.*, a biomass plant that uses both renewable biomass feedstock and non-renewable natural gas). For multi-fuel facilities, only the percentage of generation attributable to renewable fuel inputs will count as RPS-eligible electricity.<sup>84</sup> However, if the total annual amount of nonrenewable energy resources used at the facility does not exceed a *de minimis* amount set by the CEC, then 100 percent of the electricity produced by the facility can be RPS-eligible.<sup>85</sup> The *de minimis* threshold is 2 percent of all energy inputs used and measured on an annual total energy input basis.<sup>86</sup> The percentage of the total generation attributable to the RPS-eligible source is determined by the ratio of the eligible renewable energy input (MMBTU) to the total energy input (MMBTU) contributing thermal energy to generate electricity or improve the efficiency by adding heat.<sup>87</sup>

The percentage of the total generation attributable to the RPS-eligible source shall be determined by the ratio of the eligible renewable energy input (MMBTU) to the total energy input (MMBTU) contributing thermal energy to generate electricity or improve the efficiency by adding heat to the system based on the methodology provided on pages 31 and 32 of the RPS Eligibility Guidebook.

### **Can Distributed Generation Count Towards RPS Compliance Obligations?**

Distributed generation is typically small-scale electricity generation that primarily offsets all or part of a customer’s on-site electrical load. Distributed generation is

often sited at a customer’s site or close to a load center. In contrast, a central station is not used primarily to serve the on-site electrical load, but instead serves the electrical needs of a large number of offsite customers. Distributed generation may or may not be interconnected to the electrical transmission grid.<sup>88</sup>

As a general rule, CEC will not certify distributed generation and other forms of customer-sited renewable energy into the RPS. However, there are limited exceptions being established in concert with CPUC regulations. The CEC has determined it may certify as RPS-eligible facilities that might otherwise have been considered non-eligible distributed generation facilities, except that they are participating in a standard contract/tariff executed pursuant to Public Utilities Code 399.20, as implemented through the CPUC Decision 07-07-027 (R.06.05.027), executed pursuant to a comparable standard contract/tariff approved by a local publicly owned electric utility (POU), or facilities which are owned by a utility and meet other requirements.<sup>89</sup>

In addition, the CPUC recently authorized a new process called the Renewable Auction Mechanism, or RAM, for the procurement of smaller renewable energy projects (up to 20 mega watts) that are eligible for the RPS program.<sup>90</sup> The CPUC adopted the RAM as a primary contracting tool for the smaller distributed generation market segment in order to promote competition and elicit the lowest costs for ratepayers, encourage the development of resources that can utilize existing transmission and distribution infrastructure, and contribute to RPS goals.<sup>91</sup> As such, the CPUC ordered the large IOUs to procure up to 1,000 megawatts (MW) of system-side renewable distributed generation (projects up to 20 MW in size) through a reverse auction using a standard contract. The CPUC Resolution E-4414 on August 18, 2011 contemplates streamlined pro forma contracts with standard terms that are not negotiated.<sup>92</sup>

The RAM evolved from the CPUC's inquiry into expanding the existing feed-in tariff program for generators 1.5 MW and below, pursuant to Public Utilities Code Section 399.20.<sup>93</sup> However, RAM is distinct from a feed-in tariff as that term has traditionally been used. While it is a streamlined contracting mechanism and utilizes a standard contract, RAM relies on market-based pricing, utilizes project viability screens, and selects projects based on least cost rather than on a first-come first-served basis at an administratively determined price.<sup>94</sup>

### **How do the Programs Treat Cogeneration?**

Under the RPS, cogeneration is not considered a renewable resource unless the cogeneration includes feedstock from a renewable fuel listed above. Emissions from cogeneration are subject to the cap and trade program's GHG emissions cap, and cogeneration accordingly can give rise to a compliance obligation under the program.

### **Are Emissions from Certain Sources and Fuels Excluded from a Compliance Obligation under the Cap and Trade Program?**

Yes, emissions from certain sources and fuels do not generate a compliance obligation under the cap and trade program, including (with limitations and restrictions too detailed to describe here) emissions from certain subsets of the following sources and fuels:

- CO<sub>2</sub> combustion emissions from combustion of certain biomass-derived fuels, including:
  - o The biogenic fraction of solid waste and municipal solid waste materials
  - o Wood wastes
  - o Agricultural crops or waste
  - o Biodiesel
  - o Fuel ethanol (including denaturant)
  - o Biomethane and biogas

- Process, vented, and fugitive emissions from:
  - o Geothermal generation
  - o Natural gas hydrogen fuel cells
  - o Asphalt blowing operations, equipment leaks, storage tanks, and loading operations at refineries
  - o Low bleed pneumatic devices
  - o High bleed pneumatic devices (if prior to January 15, 2015)
  - o Sources for which emissions are estimated using leak detection
  - o Imported carbon dioxide
  - o Carbon dioxide exported for purposes other than geologic sequestration
- Vented and fugitive emissions from:
  - o Storage tanks used in petroleum and natural gas production or natural gas transmission
  - o Certain local distribution companies
  - o Certain well-site centrifugal and reciprocating compressors<sup>95</sup>

### **Can RECs Be Traded?**

Yes. RECs can be traded to facilitate RPS compliance.<sup>96</sup> However, Senate Bill 2 sets maximum limits for using TRECs:<sup>97</sup>

- Up to 25% of RPS requirements until December 31, 2013
- Up to 15% during the December 31, 2014 to December 31, 2016 compliance period
- Up to 10% thereafter<sup>98</sup>

Generally speaking, RECS facilitate compliance with the RPS by allowing the environmental attributes of renewable generation to be bought and sold independently of the underlying energy. RECs essentially monetize the environmental benefits inherent in such generation, providing renewable energy developers with an additional revenue stream and increase the financeability of renewable energy projects.

### **Can The Compliance Obligations Be Waived?**

The RPS compliance obligations can be waived to some degree. Under the RPS, Senate Bill 2 authorizes the

CPUC to assess penalties on non-POU sellers<sup>99</sup> that fail to procure sufficient renewable energy resources to comply with the RPS requirements.<sup>100</sup> However, Senate Bill 2 incorporates protections for CPUC-regulated sellers who encounter difficulties in complying. The RPS previously allowed the CPUC to delay compliance requirements for up to three years if certain conditions were satisfied.<sup>101</sup> 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:<sup>102</sup>

- 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.<sup>103</sup> 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.<sup>104</sup> The seller must demonstrate to the CPUC that it requires the reduction for reasons outside its control.<sup>105</sup>

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.

Although the cap and trade program does not contain a waiver provision, it does contain other provisions intended to manage the price of allowances. The cap and trade regulations provide for Allowance Price Containment Reserve auctions, to take place six weeks after each quarterly allowance auction, in an attempt to ensure that allowances are available to covered entities. The cap and trade regulations also allow entities to meet a certain portion of their compliance obligations using offsets. Offsets may be used to satisfy 8 percent of an entity’s compliance obligation (and sector-based offset credits are limited to 2 percent of an entity’s compliance obligation for the first compliance period and 4 percent of an entity’s compliance obligation for the second compliance period).<sup>106</sup> The cap and trade regulations also allow for the banking of allowances.<sup>107</sup>

#### Endnotes

- <sup>1</sup> See Client Alert No. 539, California Legislature Approves the “California Global Warming Solutions Act of 2006,” Schwarzenegger Announces Intent to Sign, Sept. 5, 2006, available at [http://www.lw.com/upload/pubContent/pdf/pub1650\\_1.pdf](http://www.lw.com/upload/pubContent/pdf/pub1650_1.pdf).
- <sup>2</sup> Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information of September 12, 2011, p. 1.
- <sup>3</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95801.
- <sup>4</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(55).
- <sup>5</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852.
- <sup>6</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(8).
- <sup>7</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95820; Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870.
- <sup>8</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(8).

- <sup>9</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95854.
- <sup>10</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95801.
- <sup>11</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95841.
- <sup>12</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95851.
- <sup>13</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95811.
- <sup>14</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95812. As to the lookback period, if an entity's reported emissions in any year from 2008 to 2011 exceed the thresholds, the entity is a covered entity as of January 1, 2013 (and remains so unless emissions drop below 25,000 metric tons CO<sub>2</sub>e/year or the entity ceases reporting in compliance with the mandatory reporting regulation). *Id.*
- <sup>15</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95851.
- <sup>16</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95820; Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870.
- <sup>17</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870.
- <sup>18</sup> Appendix A to Proposed 15-Day Modifications of the Cap-and-Trade Regulation of July 25, 2011.
- <sup>19</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95913(c)(3).
- <sup>20</sup> Appendix A to Proposed 15-Day Modifications of the Cap-and-Trade Regulation of July 25, 2011.
- <sup>21</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892.
- <sup>22</sup> Appendix A to Proposed 15-Day Modifications of the Cap-and-Trade Regulation of July 25, 2011.
- <sup>23</sup> Appendix A to Proposed 15-Day Modifications of the Cap-and-Trade Regulation of July 25, 2011.
- <sup>24</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870(e)(3).
- <sup>25</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870(b)(2); Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95870(f).
- <sup>26</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95910.
- <sup>27</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(b).
- <sup>28</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95913.
- <sup>29</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b). This obligation is subject to certain thresholds.
- <sup>30</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b)(1)(A). This obligation is subject to certain thresholds. The cap and trade regulation specifically exempts certain emissions from a compliance obligation, including (with limitations and restrictions too detailed to describe here) emissions from certain subsets of the following sources and fuels:
- CO<sub>2</sub> combustion emissions from combustion of certain biomass-derived fuels, including:
    - The biogenic fraction of solid waste and municipal solid waste materials
    - Wood wastes
    - Agricultural crops or waste
    - Biodiesel
    - Fuel ethanol (including denaturant)
    - Biomethane and biogas
  - Process, vented, and fugitive emissions from:
    - Geothermal generation
    - Natural gas hydrogen fuel cells
    - Asphalt blowing operations, equipment leaks, storage tanks, and loading operations at refineries
    - Low bleed pneumatic devices
    - High bleed pneumatic devices (if prior to January 15, 2015)
    - Sources for which emissions are estimated using leak detection
    - Imported carbon dioxide
    - Carbon dioxide exported for purposes other than geologic sequestration
  - Vented and fugitive emissions from:
    - Storage tanks used in petroleum and natural gas production or natural gas transmission
    - Certain local distribution companies
    - Certain well-site centrifugal and reciprocating compressors. *Id.* at § 95852.2.
- <sup>31</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95852(b)(1)(B).
- <sup>32</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95802(a)(264).
- <sup>33</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95852(b)(3).
- <sup>34</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95852(b)(3)(D).

- <sup>35</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(71); Proposed Modified Regulation for the Mandatory Reporting of Greenhouse Gas Emissions of September 12, 2011 § 95102(a)(108).
- <sup>36</sup> See *supra* note 21; Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95852(b)(1)(B).
- <sup>37</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(225).
- <sup>38</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b)(1)(B).
- <sup>39</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b)(4).
- <sup>40</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b)(4)(C).
- <sup>41</sup> Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information of September 12, 2011, pp 10-11.
- <sup>42</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(251).
- <sup>43</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95890(b); Electric Distribution Utilities qualified for direct allocation of California GHG allocations are allowed use of a Limited Use Holding Account, which may not hold any compliance instruments other than the Electric Distribution Utility's direct allocation. *Id.* at § 95831(a)(3). Any compliance instruments held in the Limited Use Holding Account may only be transferred to the Auction Holding Account. *Id.* at § 95831(a)(3).
- <sup>44</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(a).
- <sup>45</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(c)(1).
- <sup>46</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(b).
- <sup>47</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(c)(2).
- <sup>48</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95892(e).
- <sup>49</sup> 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.
- <sup>50</sup> 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](http://apps1.eere.energy.gov/states/maps/renewable_portfolio_states.cfm).
- <sup>51</sup> 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."
- <sup>52</sup> 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.
- <sup>53</sup> Cal. Pub. Res. Code § 25741(a)(1); RPS Eligibility Guidebook, p. 14.
- <sup>54</sup> See Cal. Pub. Util. Code § 399.13(a); RPS Eligibility Guidebook (4th ed., January 2011), available at <http://www.energy.ca.gov/renewables/documents/index.html#rps>, p. 42.
- <sup>55</sup> RPS Eligibility Guidebook, p. 46.
- <sup>56</sup> *Id.*, p. 46.
- <sup>57</sup> California Public Utilities Commission, 33 Percent Renewables Portfolio Standard Implementation Analysis Preliminary Results at 1-4 (June 2009).
- <sup>58</sup> 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).
- <sup>59</sup> 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 . . .").
- <sup>60</sup> 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](http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0001-0050/sbx1_2_cfa_20110214_141136_sen_comm.html).
- <sup>61</sup> 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>.
- <sup>62</sup> 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).

- <sup>63</sup> 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.
- <sup>64</sup> Cal. Pub. Util. Code § 399.16(b)(1).
- <sup>65</sup> “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.
- <sup>66</sup> Cal. Pub. Util. Code § 399.16(b)(1).
- <sup>67</sup> See Cal. Pub. Util. Code § 399.16(c)(1).
- <sup>68</sup> Cal. Pub. Util. Code § 399.16(b)(3).
- <sup>69</sup> 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).
- <sup>70</sup> 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).
- <sup>71</sup> See Cal. Pub. Util. Code § 399.16(c)(2).
- <sup>72</sup> 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.*
- <sup>73</sup> 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](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](http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_0051-0100/ab_64_cfa_20090629_161423_sen_comm.html).

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. See Cal. Pub. Util. Code § 399.16(c)(3)

- <sup>74</sup> *Id.*; 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](http://www.lw.com/upload/pubContent/pdf/pub2505_1.pdf)
- <sup>75</sup> 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 . . .”).
- <sup>76</sup> 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 . . .”).
- <sup>77</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852(b)(4).
- <sup>78</sup> Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information of September 12, 2011, p. 10-11.
- <sup>79</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(286); Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95841.1.
- <sup>80</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95831(b)(6).
- <sup>81</sup> To be “delivered directly,” the electricity must satisfy at least one of the following four criteria:
- A) The facility has a first point of interconnection with a California balancing authority;
  - B) The facility has a first point of interconnection with distribution facilities used to serve end users within a California balancing authority area;
  - C) The electricity is scheduled for delivery from the specified source into a California balancing authority via a continuous transmission path from interconnection of the facility in the balancing authority in which the facility is located to a final point of delivery located in the state of California; or

D) There is an agreement to dynamically transfer electricity from the facility to a California balancing authority.

Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95802(a)(71); Proposed Modified Regulation for the Mandatory Reporting of Greenhouse Gas Emissions of September 12, 2011 § 95102(a)(108).

<sup>82</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011, § 95841.1.

<sup>83</sup> 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](http://www.lw.com/upload/pubContent/_pdf/pub2505_1.pdf).

<sup>84</sup> RPS Eligibility Guidebook, p. 30-32.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*, p. 31-32.

<sup>88</sup> RPS Overall Guidebook, p. 22.

<sup>89</sup> RPS Eligibility Guidebook, p. 29-30.

<sup>90</sup> CPUC, Decision Adopting The Renewable Auction Mechanism, Decision 10-12-048, Ruelmaking 08-08-009, December 17, 2010.

<sup>91</sup> *Id.*, p. 2.

<sup>92</sup> CPUC, Energy Division, Resolution E-4414, August 18, 2011.

<sup>93</sup> CPUC, Decision Adopting The Renewable Auction Mechanism, Decision 10-12-048, Ruelmaking 08-08-009, December 17, 2010, p. 2.

<sup>94</sup> *Id.*

<sup>95</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95852.2.

<sup>96</sup> Cal. Pub. Util. Code § 399.16(b)(3).

<sup>97</sup> 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).

<sup>98</sup> See Cal. Pub. Util. Code § 399.16(c)(2).

<sup>99</sup> 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.

<sup>100</sup> 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.

<sup>101</sup> See Cal. Pub. Util. Code § 399.14(a)(2)(C), repealed and replaced by SBX1 2 (Cal. 2011).

<sup>102</sup> See Cal. Pub. Util. Code § 399.15(b)(5).

<sup>103</sup> See Cal. Pub. Util. Code § 399.15(b)(7).

<sup>104</sup> See Cal. Pub. Util. Code § 399.16(e).

<sup>105</sup> *Id.*

<sup>106</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95854.

<sup>107</sup> Proposed Modified Cap and Trade Regulation of September 12, 2011 § 95922.

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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:

**Robert A. Wyman**

+1.213.891.8346  
robert.wyman@lw.com  
Los Angeles

**Aron Potash**

+1.213.891.8758  
aron.potash@lw.com  
Los Angeles

**Marc T. Campopiano**

+1.714.755.2204  
marc.compopiano@lw.com  
Orange County

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