

The Impact Of Tradable RECs In The California Market

A decision by the California Public Utilities Commission earlier this year permits RECs generated outside the state to count toward RPS compliance.

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In January, the California Public Utilities Commission (CPUC) clarified that it would permit its utilities to use a limited number of out-of-state renewable energy certificates (RECs) to comply with the state's aggressive renewable portfolio standard (RPS). Under the CPUC order, investor-owned utilities (IOUs) and electric service providers (ESPs) are permitted to use so-called tradable RECs (TRECs) to meet up to 25% of their annual RPS compliance obligations.

In California, utilities are required to purchase 33% of their electricity from renewable energy by 2020 under Senate Bill 2, which passed the California Assembly in March. As of press time, California Gov. Jerry Brown had not signed the bill. Most states measure compliance with the RPS requirement through RECs, whether obtained in connection with the purchase of energy directly from a renewable generator or separately.

Thus, RECs derive monetary value through their use as a mechanism to comply with state RPS requirements. The sale of RECs by renewable generators separate from the energy produced provides an additional source of revenue for renewable energy projects. This is particularly

useful in project development because the installed cost of many renewable generation technologies exceeds the cost of traditional fossil-fuel-powered generation facilities.

California first considered RECs in 1994 during market restructuring.

Although RECs do not necessarily close the cost gap between renewable energy and fossil-fuel generation, they do contribute to the project's return on investment. In the aggregate, RECs have promoted the development of renewable energy by enabling developers to build economies of scale that reduce technology costs and carve out a space for renewable sources of energy within the electricity markets.

A brief history

The concept of RECs was derived from the idea of tradable obligations developed under a program in New Jersey in the mid-1980s, which allowed suburban municipalities to transfer a portion of their affordable

housing obligations to low-income households in urban areas. California first considered the use of RECs in an electric utility concept in 1994 during the CPUC's consideration of electricity market restructuring. Renewable energy advocates were concerned at the time that the requirement for regulated utilities to maintain public purpose programs, such as energy-resource diversity and energy efficiency, would jeopardize the deployment of renewable electricity generation due to the longer investment horizons and increased investment risk associated with the development of these projects.

To address this problem, the CPUC directed the formation of a working group to study the impact of an RPS. The working group's reported results in August 1996 provided an overview of what a REC program might look like – tradable certificates of proof that a given amount of electricity has been generated by an appropriate renewable fuel source, which can be marketed as a separate product from the power itself.

This construct was not adopted into California law until 2002. During the interim, however, the Automated Power Exchange (APX) in California established a separate wholesale market for electricity gen-

erated by renewable resource technologies. Recognizing the greater flexibility and market liquidity of separating the environmental attributes from the commodity, APX began operating a market for “green tickets” in May 1999. These wholesale green tickets were purchased and re-bundled with commodity electricity for retail green power sales.

The idea was introduced to the East Coast in 1997 during discussions between ESPs and stakehold-

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ers regarding the implementation of environmental disclosure of fuel mix and emissions data (i.e., electricity labels) in New England.

Enron proposed to separately trade the fuel and environmental attributes from the commodity, and the company’s strategy was implemented in Massachusetts by AllEnergy Marketing Co. (AMC) in May 1998, after wholesale electric energy markets were established in the state. AMC created a product that sold environmental attributes unbundled from electricity to retail customers under its renewable upgrade service.

In June 1999, the Texas Legislature passed a restructuring law that included an RPS. Shortly thereafter, in December 1999, the Texas PUC adopted the first compliance REC-trading program in the U.S.

In May 2000, the Bonneville Environmental Foundation sold RECs to the U.S. Environmental Protection Agency, the first such purchase by the U.S. government. Over the past decade, 29 states, Puerto Rico and the District of Columbia have established

RPS policies. The majority of these states have permitted the use of RECs to fulfill these obligations. In addition, other voluntary REC programs have been established around the country. However, despite several proposals, the U.S. Congress has not yet adopted a federal renewable electricity standard.

January order

Power purchase agreements for electric energy from renewable generators typically reflect two commodities: the generated energy itself and the renewable energy attribute of the electricity, which permits compliance with the state RPS. However, the renewable attributes can be unbundled, such that they are distinguishable from the commodity electricity and recorded in a certificate that may be separately traded. The benefit of unbundled RECs is that they provide developers with the ability to find buyers for the renewable attributes of the project that may need to comply with RPS requirements but are unable to purchase the energy directly from a renewable generator because of distance, intermittency or transmission inefficiencies.

California is the most recent state to authorize the use of unbundled RECs to satisfy RPS requirements. On Jan. 13, the CPUC permitted IOUs to use unbundled RECs to meet up to 25% of their annual RPS compliance obligations. The CPUC’s order specified that unbundled RECs are transactions with renewable resources in which the first point of interconnection is not with a California balancing authority or in which the associated power is not dynamically transferred to a California balancing authority. Thus, unbundled RECs, or TRECs, may come from electricity generated out of state. Before this decision, the CPUC precedent on the use of TRECs was murky.

Prior to March 15, 2010, IOUs in California were only permitted to use bundled RECs for compliance with the state’s RPS. The CPUC authorized IOUs to use TRECs up to the afore-

mentioned 25% cap. The CPUC also imposed a ceiling of \$50 on the cost of a TREC that could be passed through to consumers. The CPUC reasoned that this price ceiling was “a method to protect IOU ratepayers from paying for TRECs at excessive prices in the early stages of the TREC market.”

Under the March 2010 decision, the 25% cap on TRECs and the \$50 price ceiling were set to expire on Dec. 31. Less than two months later, on May 6, 2010, the CPUC stayed the implementation of its March 2010 decision in order to consider a joint petition for modification filed by three large California IOUs.

That decision also imposed a moratorium on the TREC program. The joint petition sought modification of the criteria used to determine whether a contract was a TREC transaction – the 25% cap, the \$50 price ceiling and the earmarking provision. The latter is “a flexible compliance mechanism by which deliveries from a future RPS procurement contract may be designated to make up, within three years, shortfalls in RPS procurement in the same year in which the earmarked contract was signed.”

The CPUC denied the joint petition in its Jan. 13 decision. Instead, it extended the expiration date on the 25% cap and \$50 price ceiling to Dec. 31, 2013. In addition, the CPUC issued a separate decision in which it implemented Section 365.1 under the California Public Utilities Code and extended the same RPS to ESPs as applied to the three large IOUs. Thus, the CPUC extended the 25% cap to ESPs.

While subjecting the ESPs to the same obligation to purchase renewable energy and permitting them to satisfy that obligation in part through the acquisition and retirement of TRECs, the CPUC decided not to impose a cap on the price that ESPs could pay for TRECs because there is “neither a statutory nor a practical need to impose any limit on payments for TRECs on ESPs.”

The CPUC's new policy permitting TRECs to be used to satisfy the IOU and ESP RPS requirements will facilitate investment in out-of-state renewable energy projects. This will increase the incentive for the deployment of renewable energy technologies in neighboring states, as RECs

generated in western states can now be sold into California for compliance with the state's RPS.

Accordingly, this new policy will likely improve the liquidity of RECs in the states participating in the Western Renewable Energy Generation Information System – the renewable energy

registry and tracking system for the Western Interconnection. **NP**

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