Client Alert.

December 20, 2011

Navigating California's New 33% RPS Law: Key California PUC decision on qualifying RPS portfolio content categories, compliance, and retroactivity

By Dian M. Grueneich and Cara Goldenberg

On December 15, 2011, the California Public Utilities Commission (CPUC) unanimously approved a decision implementing key provisions of California's new 33% Renewable Portfolio Standards (RPS) law.[1] That law added § 399.16 to the California Public Utilities Code, establishing three new *portfolio content categories* (described as "buckets" in the statute) for California RPS procurement. The new law makes major changes in California's RPS program and will have a profound impact on future RPS procurement and investment. While the new decision provides critical guidance, the actual implementation will require complex judgments in the ever-changing world of power purchase agreements (PPAs), related agreements dealing with resale of energy and ancillary services, contract amendments, and CPUC regulatory approval, to name but a few areas dramatically affected by the new law and CPUC decision.

The new decision provides practical guidance to retail sellers—investor-owned utilities (IOUs), electric service providers (ESPs), and community choice aggregators (CCAs)—on the criteria for inclusion in each of the new RPS portfolio content categories that apply to RPS procurement associated with contracts and ownership agreements executed after June 1, 2010. This decision requires all retail sellers to provide sufficient information about their RPS procurement for Commission staff to make a compliance determination that the retail seller's RPS procurement actually meets the requirements of the portfolio content category for which it is claimed. In addition, IOUs are required to provide specific information to the Commission in their advice letters seeking approval of RPS procurement contracts that will allow Commission staff to evaluate the categorization of the planned procurement and the value and risk of procurement in those categories to IOU ratepayers. Going forward, there will be substantially greater complexity in the type of information submitted for both approval of RPS procurement contacts and for retail seller compliance determinations. This new decision will also affect contract amendments and contracts executed prior to June 1, 2010.

This decision also confirms a previous ruling, which states that small and multi-jurisdictional California utilities are not required to comply with the statutory limitations on procurement in each of the new portfolio content categories.

BACKGROUND

The Legislature enacted California's new 33% RPS bill—Senate Bill (SB) 2 (1X)—earlier this year; the bill itself became effective December 10, 2011. SB 2 (1X) requires all California retail sellers to procure 33% of their retail energy sales from eligible renewable sources by 2020. The bill also establishes three different "buckets" of RPS eligible resources: (1)

[1] Morrison & Foerster LLP released a Client Alert regarding the law titled "Leading the Nation, California Signs 33% Renewable Portfolio Standard into Law" on April 25, 2011.

in-state or in-state equivalent products, (2) firmed and shaped products that provide incremental power, and (3) unbundled renewable energy credits (RECs) and other RPS products. The CPUC opened a proceeding (Rulemaking 11-05-005) on May 5, 2011, to provide direction on the new law and continue its oversight of California's RPS program. More than 40 parties participated in the CPUC case, offering a wide range of views on interpretation of the new law. This decision addresses the "buckets" and several related issues.

RPS PORTFOLIO CONTENT CATEGORIES

This decision, out of many needed to implement the complex provisions of SB 2 (1X), uses the term "portfolio content categories" instead of "buckets," the term used in SB 2 (1X), and offers further clarification describing the particular transactions that fall into each of these three categories.

Category 1: Interconnected to a California Balancing Authority, Scheduled Without Substitution, and Dynamically Transferred Energy

The CPUC's decision follows SB 2 (1X) in mandating that no less than 50% of eligible RPS procurement for the first compliance period ending December 31, 2013, 65% for the second compliance period ending December 31, 2016, and 75% thereafter, is required to meet Category 1 conditions. In comparison, transactions that qualify for the other two portfolio content categories can have a combined market share ultimately limited to no more than 25%, with the third category decreasing to 10% by the third compliance period.

The decision provides that a transaction involving RECs "bundled" with renewable energy generated within a California balancing authority or RECs bundled with renewable energy generated outside a California balancing authority, but scheduled into a California balancing authority utilizing some form of transmission agreement, qualifies under this first portfolio content category. However, the utility purchasing out-of-state RPS power through the use of transmission capacity will be obligated to show that the electricity will be scheduled from the eligible renewable energy resource into a California balancing authority without substituting from another source.

While the CPUC considered making firm transmission rights necessary in order to ensure that the RPS-eligible energy meets this new criterion, the Commission concluded that firm transmission is not needed under the new law. However, the decision points out that it may be commercially advantageous for a generation facility to have firm transmission rights when negotiating the terms of the sale of its RPS-eligible energy to a California retail seller, as it may simplify the retail seller's task in showing that procurement claimed to meet this criterion actually did so. Also, this criterion requires the transmission path from the renewable generating facility to the California balancing authority be shown in real time. Since there are no current measuring technologies that can provide all the information necessary for the Commission to determine with a high level of confidence that RPS procurement could or did meet the statutory requirements, modification of existing systems or the development of new ones will be necessary.

A separate criterion for this portfolio content category is that the RPS-eligible generation facility providing the electricity has an agreement to dynamically transfer electricity to a California balancing authority. The term "dynamic transfer" refers to a range of methods by which a balancing authority receiving electricity generated in another balancing authority area may provide some or all of the functions and services typically provided by the balancing authority in which the generation facility is interconnected.

Category 2: Firmed and Shaped Transactions Providing Incremental Energy

SB 2 (1X) specifies that transactions in this category include "firmed and shaped" products "providing incremental electricity." However these terms are not defined in the bill. The new CPUC decision states that the general characterization of a firmed and shaped transaction needs to include three commercial elements:

> 1) the buyer's simultaneous purchase of energy associated with the RECs from the RPS-eligible generation facility without selling the energy back to the generator; and
>
> 2) the availability of the purchased energy to the buyer (i.e., the purchased energy must not in practice be already committed to consumption by another party); and
>
> 3) the initial contract for substitute energy is acquired no earlier than the time the RPS-eligible energy is purchased and no later than prior to the initial date of generation of the RPS-eligible energy under the terms of the contract between the buyer and the RPS-eligible generator.

Under the new decision, a firmed and shaped transaction must also provide "incremental electricity" that is "scheduled into a California balancing authority." The Commission interprets "incremental" as "not in the portfolio of the retail seller prior to the firmed and shaped transaction." This requirement is meant to prevent the possibility of firmed and shaped deals meeting the criteria of this category by "tagging" RECs to any substitute energy identified by the retail seller.

Moreover, the Commission concluded that in order to protect ratepayers from unreasonable costs and to help ensure that firmed and shaped transactions are sufficiently well defined, all IOUs must adopt a contract (or subsequent contracts) for substitute energy that is either at least five years in duration, or as long as the contract for RPS-eligible energy, whichever is shorter. This five-year minimum does not apply to the contracts of CCAs and ESPs.

Category 3: Unbundled RECs and Electricity that Does Not Qualify Under Other Categories (Other Products)

This portfolio content category contains unbundled energy credits and all other RPS products that fail to qualify under the other two categories, as well as any RPS products where any fraction of electricity generated does not qualify under the other two categories. As with passage of SB 2 (1X), REC treatment was a very controversial item in the CPUC's proceeding leading to the new decision.

The CPUC decision concludes that this criterion is intended to cover a quantity of RPS-eligible generation that was projected to meet a particular criterion, but for some reason, did not do so. For example, a firmed and shaped transaction could include some substitute electricity that is not scheduled in the calendar year of the RPS-eligible generation. Any fraction of the electricity generated may be understood to apply to electricity that is scheduled into a California balancing authority without substituting electricity from another source, but is generated in excess of the schedule.

This category includes all unbundled RECs, which are RECs unbundled from the RPS-eligible generation with which they were originally associated and sold separately. Regardless of whether the original generation and RECs would have counted in the "bundled" category under earlier rulings, if the RECs had been retired for RPS compliance without being transferred, once they are unbundled and transferred the RECs are by definition unbundled RECs and subject to the rules of this portfolio content category. Moreover, the Commission clarifies that once RECs have been unbundled and sold separately from the RPS-eligible electricity with which they were originally associated, the electricity may not be used for RPS compliance.

Pursuant to SB 2 (1X), no more than 25% of eligible RPS procurement can qualify under Category 3 conditions for the first compliance period, 15% for the second, and 10% thereafter.

RESALE LIMITATIONS

The decision also clarifies under which circumstances a retail seller can buy all or part of a contract for RPS procurement entered into by another entity and claim it for RPS compliance in the same portfolio content category as would have been used for the original contract. The decision allows resales to count in the same portfolio content category, "so long as certain conditions are met, to ensure that the resale is not simply an elaborate transfer of unbundled RECs." The requirements apply to all contracts for resale signed after the effective date of the decision, December 15, 2011.

PRE-JUNE 1, 2010 CONTRACTS

Section 399.16(d) sets special rules for contracts or ownership agreements executed prior to June 1, 2010. It specifies that such agreements count in full towards the RPS procurement requirements if three specified conditions are met. The CPUC agreed that this language meant that the limitations on the use of procurement in each of the three portfolio content categories do not apply to procurement from contracts signed prior to June 1, 2010, so long as the three qualifying conditions are met, with one caveat. The decision concludes that the general exemption from the usage limitations in the new law applies only to RECs retired for RPS compliance from the originally contracted procurement. If any RECs from a contact signed prior to June 1, 2010, are unbundled and sold separately after June 1, 2010, the underlying energy may not be used for RPS compliance and the unbundled RECs will be counted in accordance with the limitations described in the third portfolio content category. The Commission notes the complex issues of interpretation going forward regarding this section.

LOOKING AHEAD

New Public Utilities Code section §399.16 is a foundation of California's renewables future. While this decision is only one out of many to come that are needed to execute the U.S.'s most ambitious RPS procurement plan, it is a crucial step in bringing California towards its 33% RPS goal by 2020.

Understanding and meeting the parameters for RPS procurement under the new portfolio content categories is going to be a complex process for everyone involved. There are new burdens on the Commission, its staff, and retail sellers. Equally important, renewable developers and investors will need to understand in full the new law, this decision, and evolving implementation requirements to ensure compliance with California's RPS program.

Morrison & Foerster has extensive experience in every aspect of the procurement, regulatory approval, siting, and financing of renewable energy projects. If you need assistance with any stage of your energy development project, please contact Dian Grueneich or Cara Goldenberg.

Dian Grueneich
(415) 268-6976
dgrueneich@mofo.com

Cara Goldenberg
(415) 268-6121
cgoldenberg@mofo.com

Dian M. Grueneich is a partner in Morrison and Foerster's San Francisco office. She has specialized in energy law for more than 30 years and most recently was a former Commissioner of the California Public Utilities Commission (2005–2010), involved in key aspects of California's renewable and distributed generation efforts, including overseeing transmission permitting.

Cara Goldenberg is the Energy Regulatory Research Specialist at Morrison & Foerster's San Francisco Office responsible for assisting in the research and analysis of California, U.S., and international regulatory matters and renewable/energy project procurement and permitting activities.

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for eight straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.