Davis Wright Tremaine LLP

CPUC Authorizes Use of Tradable Renewable Energy Credits

Déjà vu all over again

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On Jan. 13, 2011, by a 3-0 vote, the California Public Utilities Commission (CPUC) announced a decision again authorizing the procurement of tradable renewable energy credits (TRECs) by the three largest California investor-owned electric utilities (IOUs) to satisfy a portion of their obligations under the California Renewables Portfolio Standard (RPS) program (2011 TREC Decision).

The 2011 TREC Decision essentially reinstates the Commission's decision of March 16, 2010 (March 2010 Decision). The March 2010 Decision had initially authorized the use of TRECs for purposes of RPS compliance.

An earlier DWT advisory featured the March 2010 Decision and can be found here.

The 2011 TREC Decision thus ends the almost year-long stalemate in which the CPUC and the Legislature debated the integration of TRECs into the overall RPS program. The "product" of the administrative morass has been primarily delay and uncertainty—during that period, the CPUC allowed no TREC transactions.

The March 2010 Decision limits the three largest California IOU's use of TRECs for RPS compliance to not more than 25 percent of the IOU's annual RPS megawatt-hour (MWh) purchases. In addition, the CPUC set an "interim" price cap of $50 per MWh for the purchase of a TREC. Besides lifting the stay on the March 2010 Decision, the 2011 TREC Decision makes no substantive change, other than extending the period in which these caps on TREC use and costs will remain in effect until at least December 2013.

Background

CPUC-regulated entities have been required to procure RPS power exclusively through "bundled" contracts, (i.e., an integrated transaction in which the CPUC-regulated entity purchases both the physical energy and TRECs from one seller). Implementation of the 2011 TREC Decision will allow CPUC-regulated entities to procure TRECs separate from their associated energy (i.e., an RPS generator may now sell its physical energy to one entity, and in a separate transaction, sell the TRECs associated with that physical energy to a California utility). This additional flexibility for CPUC-regulated entities should provide incentives for the development of RPS power by offering additional revenue streams potentially available to RPS project developers, both in- and out-of-state.

The 2011TREC Decision provides a modicum of closure to the state's almost half-decade odyssey to implement the 2006 legislation authorizing the CPUC to approve TREC transactions. The CPUC issued several proposed decisions in 2008 and 2009 authorizing TRECs, but each of these initiatives was criticized by the IOUs, generators, or consumer groups and eventually withdrawn or simply not acted upon by the CPUC.

In 2009, the California Legislature enacted SB 14 and AB 64, and thus for a period it emerged as the entity with primary responsibility to formulate the state's TREC program. Together, these bills would have authorized the IOUs to use TRECs for RPS-compliance purposes. They would have also limited the amount of out-of-state purchases of RPS-qualified MWh which could be eligible as TRECs. In October 2009, then-Governor Arnold Schwarzenegger vetoed SB 14 and AB 64, largely on the grounds that they discriminated against out-of-state RPS power.

Following the demise of SB 14 and AB 64, in March 2010, the CPUC issued a "final" decision authorizing TRECs—the March 2010 Decision. This decision limited each of the three largest IOU's use of TRECs for RPS compliance to not more than 25 percent of the IOU's annual RPS MWh purchases, treated most out-of-state purchases as TRECs, and changed the designation of certain contracts the CPUC previously approved as "bundled" as TRECs. The 2010 March Decision had also imposed a price cap of $50 per MWh for the three largest IOUs.

The March 2010 Decision's designation of almost all out-of-state RPS transactions as TRECs is inconsistent with the determinations by the California Energy Commission (CEC) that certain commercial arrangements by out-of-state generators could qualify their RPS sales to California utilities as "bundled" transactions. The reclassification of contracts previously approved as bundled into TRECs (and thus subject to the TREC cap) contravenes the CPUC's long-standing and appropriate regulatory practice of not changing the terms of power-purchase agreements it has previously approved.

The March 2010 Decision was accordingly challenged by the IOUs and generators on several grounds, including that (i) the combination of the low TREC cap and the recategorization of existing bundled contracts as TRECs would likely mean that no out-of-state RPS generator would be able to participate in the California RPS program; and (ii) the CPUC's recategorization of the approved bundled contracts was unlawful, engendered regulatory uncertainty, and violated CPUC policy of not ordering retroactive changes to already-approved power-purchase agreements.

In response, in May, the CPUC stayed the March 2010 Decision pending its disposition of two Petitions for Modification of the March Decision—one filed jointly by Southern California Edison Company, Pacific Gas and Electric Company, and San Diego Gas & Electric Company, and the other by the Independent Energy Producers Association. During the stay, the CPUC did not approve any transactions, as classified by the March 2010 Decision, as using TRECs.

The CPUC initially targeted June 2010 as the date for its resolution of the Petitions and removal of the stay. However, during this period the Legislature considered TREC-related legislation which would essentially trump any action by the CPUC. SB 722 would have authorized TRECs, but would have largely restricted the use of out-of-state RPS power by designating such purchases of out-of-state power as TREC purchases and capping TREC purchases to no more than 25 percent of an IOU's total RPS MWh purchases. SB 722 would have, however, determined that RPS contracts previously approved as bundled by the CPUC would be "grandfathered" and thus would not count against the TREC cap. The Legislature however failed to pass SB 722.

During the last days of the legislative session in September 2010, CPUC President Michael Peevey issued a new Proposed Decision that would have set the TREC cap at 40 percent. However, the day before the CPUC decision conference in October and apparently for the purpose of securing additional votes, President Peevey issued yet another Proposed Decision (Peevey October 2010 PD). This version of the Peevey PD reduced the TREC cap to 30 percent.

Seemingly to block immediate consideration of the Peevey October 2010 PD at the October decision conference, then Commissioner Dian Grueneich issued an Alternate Proposed Decision (Grueneich PD). The Grueneich PD sought to deny the two Petitions, lift the stay, preserve the March 2010 Decision's TREC cap at 25 percent, and eliminate the expiration date for the TREC cap and price cap altogether. The issuance of the Grueneich PD triggered procedural rules delaying the possibility of any final decision by the CPUC on TRECs until at least December 2010.

However, during its December decision conferences, the then five-member CPUC did not adopt either the Peevey October 2010 PD or the Grueneich PD. At the end of the year, the terms of Commissioner Grueneich and another Commissioner expired, leaving the CPUC with only three members, awaiting new appointments by incoming Governor Jerry Brown.

To most observers the expiration of Commissioner Grueneich's term suggested that the CPUC would adopt the Peevey October 2010 PD. In yet another unexpected twist, on Jan. 7, President Peevey again revised his Proposed Decision (Peevey January 2011 PD). Most surprisingly, the Peevey January 2011 PD essentially adopts the more restrictive TREC program proposed by the Grueneich PD.

The Peevey January 2011 Proposed Decision

In particular, the Peevey January 2011 PD (i) caps the TREC MWh that may be included for RPS compliance purposes to 25 percent; (ii) effectively designates almost all contracts with out-of-state RPS generators as involving TRECs and thus subject to the TREC cap (effectively overruling the CEC's policies on the eligibility of out-of-state generators to qualify for participation in the California RPS program); and (iii) with some very limited grandfathering, reclassifies RPS contracts with out-of-state generators that had been approved as "bundled" into TREC transactions.

Speculation abounds regarding the apparent about-face by President Peevey—the only change in the "facts" is that on Jan. 3, Jerry Brown was inaugurated as the Governor. Regardless of the reasons, on Jan. 13, the three remaining Commissioners unanimously adopted the Peevey January 2011 PD—thus ending perhaps for some period the enduring TREC saga.

However, particularly given the history of the TREC wars, it is unlikely that any matter is settled. First, the Legislature again has before it TREC legislation (SB 23). Requests for rehearing and judicial challenges should be expected; parties have asserted that the restrictions on TREC sales from out-of-state generators (which may prove to effectively bar such sales), violate the interstate commerce clause in the U.S. Constitution. Moreover, despite the years of study and contemplation, the 2011 TREC Decision will require additional proceedings (and inevitable controversy and associated delay), to provide the necessary guidelines and certainty to enable market participants to actually engage in TREC transactions.

Please read our previous advisory, which provides the pertinent details regarding the specifics of the March 2010 Decision, which the 2011 TREC Decision reinstates.

For more information regarding the new TREC market in California, please contact a Davis Wright Tremaine energy professional.