BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Continue Implementation and Administration of California Renewables Portfolio Standard Program.	Rulemaking 11-05-005 (Filed May 5, 2011)

COMMENTS OF PILOT POWER GROUP, INC. ON PROPOSED DECISION IMPLEMENTING PORTFOLIO CONTENT CATEGORIES FOR THE RENEWABLES PORTFOLIO STANDARD PROGRAM

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In accordance with California Public Utilities Commission Rule 14.3, Pilot Power Group, Inc. submits these opening comments on the *Proposed Decision Implementing Portfolio Content Categories For The Renewables Portfolio Standard Program* ("PD").

I. Introduction

Pilot Power Group, Inc. ("Pilot Power") desires to focus on two issues in its comments. First, Pilot Power seeks a clarification of the rules regarding subsequent sales of bundle d RPS energy and the associated RECs following a first sale. Because non -IOU LSEs often require volumes of RPS energy and RECs that may fall below the threshold that generators want to deal with, it is not uncommon for LSE's to join forces to make a purch ase. Often this takes the form of one LSE entering into the contract with the generator/seller, then simultaneously or shortly thereafter re-selling a portion of the energy and the associated RECs to the other interested LSE. Pilot Power seeks clarificat ion that when one LSE resells to another LSE bundled RPS energy and RECs (i.e., before the energy flows and, therefore, before the REC becomes unbundled through the flow and consumption of the associated energy), such bundled RPS energy and the associated RECs retain the same categorization as in the first purchase. In other words, if the first purchase is deemed to fall in category 1 (Section 399.16(b) (1)) the subsequent sale of the

still bundled RPS energy and the associated RECs likewise qualifies and c ounts under category 1.

Second, the PD correctly determines that unbundled RECs first sold by a generator that could have qualified under either category 1 or category 2 if they had been sold in a bundled transaction are, by the express terms of Section 399.16(b)(3) qualified only under category 3. However, the PD goes too far. Section 399.16(b) creates 3 categories of eligible RPS based upon the characteristics of the first sale from the generator. These categories differentiate various electricity pr oducts based upon "their impacts on the operation of the grid in supplying electricity, as well as meeting the requirements of this article" (Section 399.16(a)), and that "provide the benefits set forth in Section 399.11 " (Section 399.16(b)). All the impa cts on the operation of the grid in supplying electricity and the benefits of Section 399.11 may be, and are, determined upon the first sale from the generator. Indeed, the plain language of Section 399.16(b) in creating each of the categories focuses exc lusively on the first sale by the "eligible renewable energy resource" (i.e., the generating facility, see Section 399.12(e)). Once the first sale takes place, the category of the associated RECs sold in a subsequent transaction, either in a bundled trans action, or after the energy has been consumed and the REC unbundled thereby, should remain the same as in the first sale from the eligible renewable energy resource. If all subsequent sales are categorized as set forth in the PD as category 3, compliance for many LSEs may become virtually, if not actually, impossible. In addition, the cost of compliance will increase for all LSEs and their customers, including IOU rate payers.

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II. Bundled RPS Qualified Energy and RECs Re-Sold by an LSE Without Unbundling the RECs Should Retain The Same Categorization As In The First Sale From The Generator.

The PD fails to address the effect of a re-sale by an LSE of bundled RPS qualified energy and the associated RECs on the categorization of such transaction. While it may seem obvious that a sale of bundled eligible renewable energy and the associated RECs may qualify under either 399.16(b)(1) or (b)(2) depending on the particular circumstances, specific treatment of this issue in the PD would greatly aid the various LSEs in their procurement strategies and efforts.

Since the passage of Senate Bill 2 (1X), Pilot Power has been hampered in its efforts to procure eligible RPS energy products due to regulatory uncertainty regarding the categorizing of eligible renewable energy and the associated RECs sold to or procured from another LSE. This issue is perhaps most significant to smaller LSEs whose RPS volume requirements may not be large enough to entice generators to want to go through the time, effort and cost to transact small volumes. As a result, Pilot Power has had discussions with other LSEs regarding pooling of RPS needs to enable a larger purchase from the generator. However, trying to structure a transaction where the generator delivers energy to more than one party and transfers RECs to the WREGIS accounts of more than one party is virtually impossible. The obvious solution is for one LSE to take the lead in the transaction with the generator, then simultaneously or soon thereafter, re-selling a portion of the energy and the RECs associated with that energy to the other LSE. Prior to the passage of Senate Bill 2 (1X), this was a relatively straight forward proposition. However, since the passage of Senate Bill 2 (1X), LSEs are uncertain whether the energy and associated RECs resold would retain qualification under the same category as the original transaction (either 399.16(b)(1) or (b)(2)). As a result, completing such transactions has been deferred until the regulatory uncertainty is eliminated.

To remove r egulatory uncertainty concerning this issue, the PD should be modified to clarify that when an LSE purchases bundled energy and associated RECs from a generator , and then subsequently resells some or all of the bundled energy and the associated RECs to ano ther LSE (before the energy has been consumed), the subsequent sale retains the same categorization as the original sale.

III. The PD Goes Too Far In Classifying All Sales And Re-Sales Of RECs in Category 3.

The PD correctly concludes in the section on Charac terization of "Unbundled Renewable Energy Credits" that unbundled RECs fit within category 3 (Section 399.16(b)(3)). For example, bundled energy and RECs sold from a generating facility located within California would qualify under Section 399.16(b)(1). However, if that same facility sold only RECs without the bundled energy, under the statute those RECs could only qualify under 399.16(b)(3) as category 3. There is no statutory justification to treat such RECs as a category 1 or category 2 product.

However, the PD does not stop there. It goes too far in classifying all sales of RECs as category 3 without reference to the underlying or first sale from the generator to assist in making the appropriate classification. The PD quotes the California Supreme C ourt regarding the standards for courts or agencies to construe a statute. In this case, the Commission must:

> look to the statute's words and give them their usual and ordinary meaning. The statute's plain meaning controls the court's interpretation unle ss its words are ambiguous. If the statutory language permits more than one reasonable interpretation, courts may consider other aids, such as the statute's purpose, legislative history, and public policy. . . .
>
> Where more than one statutory construction is arguably possible, our policy has long been to favor the construction that leads to the more reasonable result. This policy derives largely from the presumption that the Legislature intends reasonable results consistent with the apparent purpose of the legislation.

Imperial Merchant Services, Inc. v. Hunt (2009) 47 Cal. 4th 381, 387-388; PD at pp. 6-7.

A. Basis For The Three Categories of RPS Products.

In this case, the plain meaning of Section 399.16 should be clear. Section 399.16(a) notes that electricity products from eligible renewable energy resources located throughout the WECC are eligible to comply with the RPS requirements. However, Section 399.16(a) states, "These electricity products may be differentiated by their impacts on the operation of the grid in supplying electricity, as well as, meeting the requirements of this article." Public Utilities Code Section 399.16(a). Section 399.16(b) states in relevant part: "Consistent with the goals of procuring the least-cost and best-fit electricity products from eligible renewable energy resources … and that provide the benefits set forth in Section 399.11, a balanced portfolio … shall be procured consisting of the following portfolio content categories". The three categories set forth in Section 399.16(b), therefore, are based on 1) the impact of products on the operation of the grid in supplying electricity, 2) procuring least-cost and best-fit products, and 3) procuring products that provide the benefits set forth in Section 399.11.

Products that meet the qualifications of category 1 clearly provide positive impact on the operation of the grid in supplying electricity. Products qualifying under category 1 also provide most or arguably all of the benefits identified in Section 399.11(b). However, products qualifying under category 1 clearly do not provide the least-cost product. In fact, they are the highest cost product. Whether they are the best-fit is also subject to debate and reasonable people could disagree. On the whole, however, products qualifying under category 1 arguably provide the most benefits to California.

Products that meet the qualification of category 2 also provide positive impact on the operation of the grid in supplying electricity. They do not, however, provide as many of the benefits identified in Section 399.11(b) as do category 1 products. However, they are lower cost

products than category 1 products. As to best fit, again reasonable people could disagree. On the whole, products qualifying under category 2 arg uably provide fewer benefits to California than products qualifying under category 1.

Finally, products that fall in category 3 arguably provide little or no positive impact on the operation of the grid in supplying electricity. While they do provide ma ny of the benefits listed in Section 399.11 (b), they do not provide as many as either category 1 or category 2 products. However, they are the least cost product, dramatically lower in price than category 1 or category 2 products. (This is not because category 3 products usually do not have any energy bundled with them.) When an LSE purchases bundled energy and RECs, the energy and the RECs are almost always priced separately in the transaction. Thus it is easy to compare solely the value or market price of the RECs bundled with category 1 products or category 2 products, with the value or market price of category 3 RECs. Already the market is showing dramatic differences in the price of the RECs in category 1, category 2, and category 3. Again, the best-fit issue is debatable and will vary from LSE to LSE, and from time to time.

Section 399.16(b) differentiates between the 3 categories based upon the legislature's view of the relative benefits to the grid and to California. Highest cate gorization is given to those products the legislature views as providing the most benefits —category 1. Categories 2 and 3 are viewed by the legislature as providing fewer benefits and being, therefore, less desirable. Through the use of a carrot and stic k, the legislature clearly wants to encourage the purchase of more category 1 products which the legislature perceives as providing more benefits to the state. In turn, the legislature hopes this will lead to the development of more category 1 resources.

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B. The Three Category Classifications Must Be Determined Upon The First Sale From The Generator.

One must look to the statute to see when and under what circumstances the statute makes its categorizations. The plain language of the statute demonstrates that the categorization must be made upon the first sale from the generator. In relevant part, Section 399.16(b) requires (emphasis added):

> …a balanced portfolio of *eligible renewable energy resources* shall be procured consisting of the following portfolio content categories:
> (1) *Eligible renewable energy resource* electricity products that meet either of the following criteria:
> (A) *Have a first point of interconnection with a California balancing authority*, *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.* The use of another source to provide real-time ancillary services required to maintain an hourly or subhourly import schedule into a California balancing authority shall be permitted, but *only the fraction of the schedule actually generated by the eligible renewable energy resource shall count toward this portfolio content category*.
> (B) *Have an agreement to dynamically transfer electricity to a California balancing authority*.
> (2) Firmed and shaped *eligible renewable energy resource* electricity products *providing incremental electricity and scheduled into a California balancing authority*.
> (3) *Eligible renewable energy resource* electricity products, or any fraction of the electricity generated, including unbundled renewable energy credits, that do not qualify under the criteria of paragraph (1) or (2).

All of the three categories focus on electricity products from an "eligible renewable energy resource". Section 399.12(e) defines an "eligible renewable energy resource" as an electrical generating facility that meets the definition of a "renewable electrical generation facility" in Section 25741 of the Public Resources Code…" On its face, therefore, the statute looks solely to the generator in determining the categorization of an electricity product, not to any subsequent seller.

The plain language of the statute also makes clear that to qualify under category 1 or 2, the generator in the first sale of an electricity product must actually provide electricity to California. When a generator has a first point of interconnection with a California balancing authority or has a first point of interconnection with distribution facilities used to serve Californians, it is clear that California is receiving the output of the facilities' generation. Section 399.16(b)(1)(A) further clarifies that this categorization is made upon the first sale from the generator when it goes on to require "or are scheduled from the eligible renewable energy resource into a California balancing authority without substituting electricity from another source. The use of another source to provide real -time ancillary services required to maintain an hourly or subhourly import schedule into a California balancing authority shall be permitted, but only the fraction of the schedule actually ge nerated by the eligible renewable energy resource shall count toward this portfolio content category." The determination whether the generator actually provided electricity to California as part of its product can only be made upon the first sale by the g enerator. Section 399.16(b)(1)(B) similarly requires the generator to "[h]ave an agreement to dynamically transfer electricity to a California balancing authority." Again, the focus is whether the generator is providing electricity to California. Section 399.16(b)(2) likewise focuses on the generator's first sale. Firmed and shaped electricity products from an eligible generator qualify as category 2 if the products provide incremental electricity and are scheduled into a Calif ornia balancing authority. The determination whether the generator provided incremental electricity into California can only be made by looking at the generator's first sale.

Under the statute category 3 determinations also must be made based upon the first sale by the generator. Section 399.16(b) (3) classifies as category 3: "Eligible renewable energy

resource electricity products, or any fraction of the electricity generated, including unbundled renewable energy credits, that do not qualify under the criteria of paragraph (1) o r (2)." Simply stated, electricity products from a renewable generator, including unbundled RECs, that do not qualify as either category 1 or category 2, fall within the catch -all of category 3. Again the focus is on the generator and its first sale of the electricity products. Only at that time can the statutory criteria be applied to determine the appropriate category.

C. Once The Categorization Of An Electricity Product Is Determined At The Time Of The First Sale By The Generator, Subsequent Sales Should Retain The Same Classification.

When a purchaser of electricity products from an eligible renewable energy resource resells those products on a forward basis prior to the electricity flowing and being consumed, naturally the resold products should r etain the same categorization as in the first sale from the generator. That issue is addressed in Section II above. Admittedly the issue of the appropriate classification of the resale of a REC that has become unbundled as a result of the electricity flowing and being consumed is, at first appearance, a more difficult issue , but only upon first appearance.

As noted above, the legislature created the three categories to differentiate between various renewable electricity products based on their perceived value and benefit to the state. Category 1 products were perceived by the legislature to provide the greatest positive impact on the operation of the grid through the supply of electrical energy, together with the greatest number of benefits identified b y the legislature in Section 399.1 1(b). Suppose that LSE1 purchases from a generator in California a bundled electricity and REC product. Further suppose that the electricity was scheduled to the purchasing LSE 1 and was consumed by retail consumers

in California. As a result of the electricity flowing, the RECs associated with the energy have become unbundled. Further suppose that through over -purchase or load migration LSE1 has more RPS than it needs and cannot bank the excess. If LSE2 has insufficien t category 1 product and contacts LSE1 to see about purchasing some of LSE1's excess category 1 product, should LSE1 be able to sell its RECs with a category 1 classification? In short, yes. All of the benefits the legislature sought to confer on the sta te of California through category 1 electricity products have been conferred on the state. The energy associated with the RECs actually flowed to California consumers providing grid stability. All the benefits under Section 399.11(b) that the bundled pro duct were expected to confer on the state at the time of the first sale from the generator, have actually been conferred on the state. Finally, as discussed above, the categorization of electricity products pursuant to a plain reading of Section 399.16(b) occurs upon the point of fir st sale by the eligible generator. Subsequent sales, even of the REC when it becomes unbundled as a result of the energy being consumed in California, should retain the same categorization as when the electricity product was first sold by the generator.

The PD assumes that repeated sales of RECs "at premium prices" "would simply drive up the cost to ratepayers (or indeed for any customers of retail sellers) and unnecessarily increase the costs of complying with the state's RPS goals without providing any additional value, since the electricity can be consumed only once and the REC can be retired for RPS compliance only once." PD at 33. This assumption, however, overlooks certain basic economic truths that markets expose. If the market price of an object is $5.00, no matter how many times it is sold, the market price is still only $5.00. Repeated sales do not drive up the price of an object. A buyer would not purchase an object for $7.00 if another seller is offering that same product at $5.00. When demand exceeds supply, however, prices tend to rise until an equilibrium is

reached and a new market price is determined. When supply exceeds demand, prices drop until a new market price is determined. By creating the three categories, the legislature has interfered with the development of market price. The creation of category 1 which contains a limited amount of supply, while simultaneously legislating an increasing and inflexible artificial demand for category 1 products is what creates and has, in this case, created premium prices. Already Pilot Power is seeing price quotes from generators for RECs associated with category 1 electricity at somewhere between $40 and $50 per REC. By contrast, the REC price for a category 3 REC is being quoted at around $4 to $5 per REC. Category 2 RECs are being quoted at around $10 per REC. (Again, this is just the REC price, without reference to the price of energy bundled with category 1 and category 2 products.)

If RECs that become unbundled because the associated energy has been consumed in California are converted to category 3 RECs upon their re-sale, three things will happen in the market. One, the available supply of category 1 products will shrink, creating an even greater supply and demand imbalance, thereby driving up the premium for category 1 products even higher. This will hurt all consumers and ratepayers. Two, the supply of category 3 products will increase, further depressing the prices for category 3 products. Three, the Commission will likely face numerous requests for waivers from LSEs that are unable to find category 1 products to satisfy their category 1 requirements.

These points can be illustrated by looking at our experiences with Resource Adequacy ("RA") in California. A few years ago, a premium RA product was created by regulation — Local RA. Overnight RA prices changed dramatically. RA qualifying and sold as Local RA commanded a high premium because of the limited supply of Local RA resources. System RA, being more plentiful, saw its prices decrease. Although prices vary from year to year, in general

Local RA sells at prices averaging approximately 300 percent of System RA pricing. Even when Local RA and System RA are purchased from the same generator and the same generating unit, the Local RA costs 300 percent more than the System RA--from the exact same generating unit.

Because of their size and market power, the IOUs are able to corner the market in various products. This is true in both RA and RPS products. The IOUs have contracted for all the Local RA in at least two of the Local zones. As a result, in order for other LSE's to meet their Local RA obligations, they have to purchase from the IOU's who control the entire supply. The IOUs, therefore, are able to re-sell the Local RA at premium prices. With regard to RPS, the IOU's already control the overwhelming majority of products that could qualify as category 1. If they continue their historic purchasing patterns, it is entirely likely that they will control all or substantially all of the category 1 electricity products—especially as the percentage of category 1 requirement increases pursuant to Section 399. 15. If other LSE's cannot purchase category 1 product from the IOU's because the re-sale by the IOUs would only qualify as category 3, then non-IOU LSEs will be forced to apply for waivers from the statutory requirement for category 1 products. In addition, if the IOUs do sell RECs that become reclassified as category 3 products, ratepayers will be economically harmed through the losses the IOUs would incur from such sales. If the IOU's simply bank any excess, then ratepayers will also be harmed by the high percentage of premium priced products in the IOU portfolios.

D. Retention Of The Original Categorization Leads To The More Reasonable Result.

Pursuant to the California Supreme Court, " [w]here more than one statutory construction is arguably possible, our policy has long been to favor the construction that leads to the more reasonable result. This policy derives largely from the presumption that the Legislature intends

reasonable results consistent with the apparent purpose of the legislation. " *Imperial Merchant Services, Inc. v. Hunt* (2009) 47 Cal. 4th 381, 387-388; PD at p. 7. In this case, the PD puts forth one construction of the statute —a construction that appears to be incorrect when the plain language of the statute is closely considered. The con struction argued herein is that subsequent sales of RPS products should retain the original categorization as the first sale from the renewable generator.

The construction advocated in the PD leads to a constriction and constraint of the market for category 1 products (and to a lesser extent category 2 products as well). The already limited and inadequate supply of products that can qualify for category 1 will grow even more limited when re-sales are re-classified as category 3. This will drive up the price of category 1 products because supply will be even more constrained. In addition, this reclassification of products from category 1 to category 3 is likely to lead to some LSE's being unable to procure category 1 products—at any cost; particularly as the IOUs continue to obtain control over more and more of the available category 1 products. Thus, many LSE's will be compelled to apply for waivers from the requirement for category 1 products. This increase in pricing for categ ory 1 products is likely to hit ratepayers especially hard as the IOU's will have in their portfolios almost all the available category 1 products.

By contrast, the construction outlined herein, that the categorization is determined upon the first sale from the generator and should be retained for subsequent sales, leads to a far more reasonable result. This construction recognizes the basis for the creation of the three categories and in no way hinders or limits the benefits the legislature seeks to o btain through the categories—all the intended benefits will be conferred on the state. This construction will prevent an already constrained supply of category 1 products from being further constrained.

This will help keep pricing from escalating even fu rther, this will aid in the creation of a market where prices can be more stable because there can be more transactions on which to base market pricing, this will aid all LSEs to procure necessary category 1 products without needing waivers, and this will ensure that ratepayers are not paying for a disproportionately high percentage of category 1 products in the IOU portfolios.

IV. Conclusion

Accordingly, the PD should be revised to:

1. Remove regulatory uncertainty regarding re -sales of bundled energy and RECs. Subsequent re-sales of bundled renewable energy and the associated RECs before the electricity has been consumed should retain the same classification as the first sale from the eligible renewable generator; and

2. Clarify that the categorization of renewable products is determined at the time of the first sale by the eligible renewable generator. Accordingly, re -sales of renewable products, even RECs that have been unbundled through consumption of the associated electricity by California consumers , retain the same categorization as the first sale from the renewable generator.

Respectfully submitted,

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VERIFICATION

I, Thomas R. Darton, am an officer of Pilot Power Group, Inc. and am authorized to make this verification on its behalf. The matters stated in the foregoing COMMENTS OF PILOT POWER GROUP , INC. ON THE PROPOSED DECISION IMPLEMENTING PORTFOLIO CONTENT CATEGORIES FOR THE RENEWABLES PORTFOLIO STANDARD PROGRAM are true of my own personal knowledge, except as to matters which are stated therein on information and belief, and as to those matters I believe them to be true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification is executed this 27th day of October, 2011, at San Diego, California.

/s/ Thomas R. Darton
Thomas R. Darton, Vice President