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)

OPENING COMMENTS OF THE WESTERN POWER TRADING FORUM ON THE PROPOSED DECISION ON IMPLEMENTATION OF NEW PORTFOLIO CONTENT CATEGORIES FOR THE RENEWABLES PORTFOLIO STANDARD PROGRAM

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I. INTRODUCTION AND SUMMARY.

In accordance with Rule 14 of the California Public Utilities Commission's ("Commission's") Rules of Practice and Procedure, the Western Power Trading Forum ("WPTF")[1] respectfully submits the following comments on the *Proposed Decision on Implementation of New Portfolio Content Categories for the Renewables Portfolio Standard Program* ("Proposed Decision").

WPTF's concern with the Proposed Decision is that it is fundamentally flawed with respect to the substantial restrictions it imposes on Renewable Portfolio Standards ("RPS") transactions – restrictions that are not required by SB 2 (1X). Such restrictions will greatly reduce compliance flexibility, adding costs which will ultimately be borne by consumers. It is our hope that, at least to some extent, these restrictions are inadvertent. That is, rather than consciously intended to impede flexibility and existing patterns of commerce, our hope is that

[1] WPTF is a California non-profit, mutual benefit corporation. It is a broadly based membership organization dedicated to enhancing competition in Western electric markets in order to reduce the cost of electricity to consumers throughout the region while maintaining the current high level of system reliability. WPTF actions are focused on supporting development of competitive electricity markets throughout the region and developing uniform operating rules to facilitate transactions among market participants.

the choices made are primarily the result of a gap in the understanding of the practical consequences of the choices made in the Proposed Decision. In these comments, WPTF intends to provide detailed explanations of the practical impacts of many aspects of the Proposed Decision, which we hope will clarify the negative consequences we foresee.

At a conceptual level, the Proposed Decision appears to get off on the wrong foot by encompassing a very narrow vision of how commerce would naturally work to enable regulated entities to fulfill their RPS obligations. The core paradigm appears to be based on the idea that utilities will enter into long-term contracts with owner/operators of eligible renewable resources. It does not appear to contemplate:

1) spot and other shorter contract term transactions

2) a secondary market in RPS-eligible energy ownership rights, especially for "Product category 1" and "Product category 2" quantities

3) the role of intermediaries between the eligible renewable resources and the ultimate compliance entity

4) the need for a compliance obligation entity to obtain "after the fact" approval of an RPS-eligible purchase made outside of the long-term contract pre-approval process. Instead, the PD overemphasizes the process for advance approval of contracts, at the expense of after-the-fact demonstrations of how a purchased product or service does, in fact, meet the requirements of SB 2 (1X).

None of the transactional restrictions imposed by the Proposed Decision as described in these comments are mandated by SB 2 (1X). Therefore, given the unnecessary burdens they place on entities with compliance responsibilities, and the manner in which they limit the participation of market intermediaries that are so important to creating a vibrant renewable products and services market, not to mention the burden the restrictions will impose on Commission staff oversight of the RPS program - the overly restrictive provisions of the Proposed Decision will inevitably convert into increased compliance costs for consumers. In the body of these comments, we will provide more detailed discussions of the problems created by the flawed components.

II. THE COMMISSION SHOULD RECOGNIZE THE FULL RANGE OF TRANSACTION TYPES USED IN A NORMAL MARKET.

The paradigm implicit in the Proposed Decision is that compliance entities will go out and sign long-term contracts with owner/operators of RPS-eligible resources. However, this paradigm fails to contemplate the following issues:

1) Many resource owner/operators do not have marketing staffs, and have already contracted with third parties to market their output. The Proposed Decision, as written, appears to immediately remove such resources from eligibility for consideration by California compliance entities, solely due to the fact that they did not contemplate the "no intermediaries" provisions (whether intended or inadvertent) in the Proposed Decision. This outcome is not required by SB 2 (1X), and it seems unlikely it was intended by the Proposed Decision.

2) Over the course of time, actual RPS needs as compared to projected supply sources will change. This can be due to actual versus projected generation from contracted sources, changes in loads (particularly if direct access is significantly expanded over the duration of the RPS program) and many other factors encountered in the normal course of business. For this reason, a vibrant secondary market in compliance instruments is needed. The key concern should be devising ways to track which "product category" a given bundle of energy or REC is in. Once a given package of energy and/or RECs has arrived in California, and has met the

requirements for eligibility in a particular "product category" under SB 2 (1X), that "package" should forever retain its "product category identity" until retired, regardless of how many times it is traded.

3) It is highly likely that much energy not already claimed under a long-term contract will arrive in California, and meet all the eligibility requirements for being counted as being in a premium "product category" (1 or 2). As long as this type of energy delivery otherwise meets all of the eligibility requirements for "product category" status, there is no reason why a compliance obligation entity that ends up in possession of such a package should not be able to use it for compliance purposes, in the product category for which it qualifies. For this reason, the Commission needs to develop a process whereby any energy and/or REC that can demonstrate its product category status can be used by a compliance entity to meet its RPS obligation. By restricting usability for compliance purposes to pre-approved contracts the Proposed Decision needlessly limits the supply of RPS eligible energy and RECS. This can have no other effect than to increase compliance costs for compliance entities, and thus, consumers. Again, nothing in SB 2 (1X) requires this approach.

4) Many smaller compliance entities, such as smaller Energy Service Providers ("ESPs") or small municipal entities, do not have large procurement staffs or real-time energy management desks. For them, it is often most cost-effective to contract with third parties to deliver "final" energy at a time and place defined by contract. The third party supplier/manager takes responsibility for all of the "upstream" activities needed to get the power delivered. By effectively prohibiting such use of third party services for RPS-eligible transactions, the Proposed Decision needlessly exposes these smaller entities to costs such as congestion, the management of which they typically outsource. This is particularly true for more complex

import transactions, and especially so for the type of import transactions that require scheduled transmission from an out-of-state resource to a California Balancing Authority ("CBA"). Despite the import role that third parties have long had in the California energy market, the Proposed Decision, as written, seems to effectively preclude third party transactions. If only stakeholders with RPS compliance obligations can procure Product Category 1 directly from renewable generation resources, there will be no liquidity or product fungibility. It should go without question that the Commission's policies should accommodate virtually all forms and permutations of purchase and sale transactions so as to create a market with multiple buyers and sellers, including intermediaries who facilitate efficient transactions. It is of paramount importance that the classification of an RPS-eligible transaction will remain the same when the transaction is transferred, as long as the structure of the transaction remains the same and the RECs have not been retired for RPS compliance.

Transferability of eligible RPS products, and a liquid market in general, is fundamental to the success of the post-SB 2 (1X) RPS market. The Commission should therefore clarify the Proposed Decision to state, for example, that a transaction that originally qualified under Public Utilities ("P.U.") Code §399.16(b)(1) or (b)(2) does not lose its classification because the transaction may be transferred later to a third party. So long as the structure of a transaction is maintained for RPS compliance (and the REC is not retired), the transaction should be understood by all parties to be transferable without any risk of losing its RPS content category.

III. THE COMMISSION SHOULD CLARIFY THAT A LOAD SERVING ENTITY OR THIRD PARTY SUPPLIER CAN MEET THE CRITERIA ESTABLISHED FOR FIRMED AND SHAPED TRANSACTIONS

The Proposed Decision clearly requires three criteria for firmed and shaped transactions:

- the buyer simultaneously purchases energy and associated RECs from an RPS-eligible generator;

- the energy purchased from the RPS-eligible generator is available to the buyer (i.e., the purchased energy must not in practice be already committed to consumption by another party);
- the buyer acquires substitute energy at the same time as it acquires the RPS-eligible energy.

However, the Proposed Decision is unclear as to the definition of what is a "buyer." The "buyer" in the foregoing definition can (or should) be allowed to be two separate entities (load serving entity "LSE" or third party supplier), but the fact that this is the case should be made much clearer than it is in the Proposed Decision. For example, a third party supplier may purchase energy and associated RECs from an eligible generator where such purchased energy is available to the third party supplier. The third party supplier may in turn enter into a firmed and shaped agreement with an LSE for substitute energy at the same time that it has acquired contractual rights to the energy and RECs from the eligible generator. In this example, the third party supplier is the buyer in the context of the first two bullet points above but the LSE is the buyer in the context of the third bullet point above. This type of transaction is exactly what facilitates a robust, liquid RPS market. It is simply unnecessary, and severely restrictive, to require the LSE to be the buyer for all three components described above.

A. The Proposed Decision Seems to Preclude a Secondary REC Market.

The Proposed Decision should be clarified to ensure that when a seller and buyer enter into a transaction that meets the criteria of P.U. Code §399.16(b)(1) (in-State) or (2) (firmed and shaped), the classification will be maintained when the Buyer transfers the transaction to a third party. When the physical flow of renewable energy under a transaction is the same, a product that qualifies under P.U. Code §399.16(b)(1) should maintain its status when it is transferred to a third party. Nor should a firmed and shaped product lose its status under P.U. Code §399.16(b)(2) if substitute energy is replaced when the transaction is transferred to a third party. As written, because both products include energy along with renewable attributes, the Proposed Decision can be understood to say that any trading of the REC after the first purchase will cause it to count only toward the REC-only category.

In fact the Proposed Decision is explicit in expressing a deeply flawed rationale for denying the value of the liquidity provided by a secondary market:

> "Once a REC is unbundled, the underlying electricity with which it was originally associated may not be used for RPS compliance; it is the REC that carries the compliance value. The unbundled REC may be sold (more than once) before it is retired for RPS compliance. Parties assume that unbundled RECs that could be counted in § 399.16(b)(1) would command a premium in the market, because they could count in this preferred category for compliance. But, if implemented, that interpretation of the statutory categories could lead to the repeated sale of RECs at premium prices. This 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." (p. 33).

The Proposed Decision specifies that any sale, transfer or trade of P.U. Code §399.16(b)(1) or (2) by the original buyer to a third party causes those products to be re-categorized to portfolio content category P.U. Code §399.16(b)(3) for RPS compliance purposes. This re-categorization is inconsistent with the definitions of the three portfolio content products in SB 2 (1X), which imposes no such this restriction on the tradability of P.U. Code §399.16(b)(2) products. The Proposed Decision's reasoning that this trading restriction will lower RPS compliance costs by ensuring that the premium price attached to the delivered energy associated with P.U. Code §399.16((b)(1) and (2) is paid for only one time is simply incorrect.

The Proposed Decision's imposition of this restriction would *increase* RPS compliance costs, and chill the development of a fungible renewable energy market.

It is a well-established economic principle that a vigorous secondary market with frequent sales and re-sales bolsters liquidity. Improved liquidity, in turn, smoothes price movements, reducing volatility. In practical effect, increased liquidity is a form of increased supply, and thus helps keep prices stable. In no way does multiple trading of a single instrument, or category of instrument, tend to increase its price. The Proposed Decision appears to assume that the only way an instrument would be re-sold is with a mark-up, and reasons from the premise that, therefore, multiple re-sales only increase prices. However, this premise has no support in economic literature. Compliance entities make decisions to buy or sell based first and foremost on need. That is, they buy when they have demand and sell when they have an excess supply. When they buy and sell, they can only do so as price takers. That is, they must accept the existing market price. This can result in a gain, a loss, or a break even situation. Only when buying or selling large volumes into or from an illiquid market can the simple decision to buy or sell move a market price. For all of these reasons, there is no logical support for the notion that selling a compliance instruments multiple times will tend to increase its price over time. Conversely, it is in the interests of all parties to have a vibrant, liquid secondary market, so that parties can adjust their portfolios to meet their needs, with minimum transactions costs.

It is important that buyers know that what they buy is what they have. For example, if an investor owned utility is "long" product content category one resources, and wants to sell some to another investor owned utility that is short product content category one resources, under this Proposed Decision, the selling utility will be penalized and could only receive the value of product content category three resources. The procuring utility will also be disadvantaged because it is likely in need of product content category one resources. The Proposed Decision should be rewritten to allow transfers and sales of products without losing the initial product content categorization, so that buyers and sellers know what they are buying and what they have.

B. Clarification of Key Concepts Are Proposed to be Deferred.

Regrettably, the Proposed Decision seems to raise more questions than it answers if one accepts the premise that there should be no secondary bundled REC market. A plethora of questions without answers arise. For example: How will a firmed and shaped structure be treated when the energy is made available to an LSE through a third party, if the LSE has a contract with the generator. In other words, can a marketer buy energy from an LSE and sell it back as firmed and shaped? Will in-state firm and shaped transactions be treated differently? Will a REC be considered bundled or unbundled under such transactions? Will a short-term bridged transaction count as a P.U. Code §399.16(b)(1) REC? The Proposed Decision is simply unhelpful in evaluating these typical commercial questions:

> "In the current RPS program, retail sellers submit semi-annual compliance reports, but their final compliance reports for a compliance year are not required until the CEC has completed its verification process for that year. D.06-10-050. New § 399.15 makes significant changes to the compliance periods and targets for retail sellers. The Commission will address the process of adjusting compliance reporting requirements to the new statutory scheme, including the new portfolio content categories, in later decisions implementing SB 2 (1X). At this time, the CEC has not indicated how it will include the new provisions in its verification process." (Fn. 12, pp. 7-8)
>
> "The upfront showing by IOUs and the after the fact compliance determination made by Commission staff will be important components of administration of the portfolio content categories. It is likely that modifications to Energy Division's advice letter template and RPS compliance spreadsheet will be required. Energy Division staff will develop the complete requirements; some may also be reflected in future decisions. In this decision, preliminary—but real—direction is given to retail sellers and Energy Division staff on how to structure such showings and determinations" (pp. 13-14).

IV. <u>THE COMMISSION SHOULD CLARIFY WHAT IS MEANT BY A "SIMULTANEOUS" TRANSACTION.</u>

The Proposed Decision requires that energy and RECs generated be traded "simultaneously" in order to qualify for P.U. Code §399.16(b)(1). Taken literally, this requirement appears to limit purchase of energy which needs to be firmed and shaped only from resource owners that can also provide the firming and shaping service. However, it appears elsewhere to be contemplated that the key is to <u>simultaneously submit</u> both the underlying RPS purchase contract and the firming and shaping contract in the same advice letter request for approval. While this second interpretation seems more likely to be the intent of the Proposed Decision, even it imposes needless restrictions on commercial activities. SB 2 (1X) only requires that the "firming and shaping" energy be generated and delivered to California in the same calendar year that the RPS-eligible energy is generated. It does not require a one-to-one correspondence of firming and shaping services contracts with RPS contracts. For example, a compliance entity might choose to sign an umbrella firming and shaping contract for all its eligible out-of-state RPS purchases. This might be done well before all of the individual purchase deals are signed. Conversely, it might also choose to sign more than one firming and shaping deal for a single RPS purchase. It might do this if the entity making the best offer does not have the capacity to fulfill the entire volume.

The underlying point is, there are more possible permutations of firming and shaping configurations than anyone can identify in advance. The reason to do it any given way is because someone has figured out a reason why doing it that way is cheaper and/or more reliable. Therefore, by definition, prohibiting such forms of contracting imposes unnecessary compliance costs. Furthermore, such requirements are not required by SB 2 (1X). Indeed, it is not clear what purpose is served by requiring approval of firming and shaping contracts at all. Instead, it would be more logical to focus on how firming and shaping service suppliers can demonstrate, after the fact, that the energy they delivered has in fact met the eligibility requirements under the statute. Simply getting a contract pre-approved does not guarantee that the actual firming and shaping activities, when performed prospectively, will comply with the eligibility requirements.

Even under the PD as drafted, there are uncertainties that would need clarifying. For example, it appears that scheduling an out of state renewable generator to an LSE would require selling the energy at an intertie outside the balancing area of the California Independent System Operator ("CAISO") and require the LSE itself to move the energy into the CAISO each hour as the energy is generated. This scenario exposes the LSE to the risk of incurring congestion costs that they may not be equipped to manage on their own without a power marketer.

In this example, because there is no opportunity to trade energy and RECs simultaneously, there is no opportunity for the ESP to buy a P.U. Code §399.16(b)(1) product from out of state. The Proposed Decision should be clarified to provide that as to a "firmed and shaped" product that qualifies under P.U. Code §399.16(b)(2), "substitute" energy might be purchased, and scheduled to a California Balancing Authority at any time within the same calendar year as the purchase of the RPS-eligible energy. The Proposed Decision should therefore be clarified to ensure that there are no restrictions on where or to whom the buyer sells the energy from an RPS-eligible generator using a firmed and shaped transaction.

The Proposed Decision requires that a P.U. Code §399.16(b)(2) Product must be firmed and shaped pursuant to a contract that is executed at the same time as the underlying transaction for a bundled energy/REC transaction. If adopted by the Commission, it will significantly reduce the flexibility that buyers need to manage their procurement of the product, and as a result will unnecessarily increase costs. What should count is that the *generation* occurs in the same year, not the *contract*. There is no reason that substitute energy must be bought at the same time. Parties should be able to procure P.U. Code §399.16(b)(1) products so long as the transaction is completed within the same compliance period that the power was generated. The simultaneous purchase and sale requirement has the effect of placing congestion risk on the generator that could otherwise be mitigated by a third party. "Firmed and shaped" products qualify under P.U. Code §399.16(b)(2) as long as the substitute energy is both "purchased" and "scheduled int" within the same calendar year.

V. **CONCLUSION.**

WPTF thanks the Commission for its consideration of these comments and urge that the Commission act expeditiously to consider and implement the recommendations discussed herein.

Respectfully submitted,

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October 27, 2011

VERIFICATION

I, Donald C. Liddell, am counsel for the Western Power Trading Forum and am authorized to make this Verification on its behalf. I declare under penalty of perjury that the statements in the foregoing copy of the Opening Comments on the Proposed Decision on Implementation of New Portfolio Content Categories for the Renewables Portfolio Standard Program, filed in R.11-05-005, are true of my own knowledge, except as to matters which are therein stated on information or belief, and as to those matters I believe them to be true.

Executed on October 27, 2011, at San Diego, California.

Donald C. Liddell
DOUGLASS & LIDDELL

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WESTERN POWER TRADING FORUM