ATTACHMENT E
Page 1

COMPLIANCE QUESTIONS	STRAW PROPOSAL	RATIONALE
Market Participants		
• Who can participate in the California compliance REC market? • Should the REC trading rules differ for third parties (any non RPS-obligated entity)?	There are no limits on market participation. To the greatest extent possible, rules should be consistent for all participants.	Limiting market participation might negatively affect market liquidity and efficiency. • Guiding Principle #8: REC trading rules, guidelines, and policies should be simple, transparent, easily administered, uniformly applied, and equitable to all LSEs.
TREC Usage Limits		
• Pursuant to Pub. Util. Code § 399.16(a)(7), the Commission may limit the quantity of tradable RECs (TRECs) procured for RPS compliance. • Should there be a limit on the quantity of tradable RECs that can be used by LSEs for RPS compliance? Should the limit be different for different classes of LSEs?	To address usage limits, a minimum quota mechanism, similar to the one set forth in D.07-05-028 for short term contracts, will be applied to TRECs. The minimum quota will allow, in any calendar year, LSEs to count short-term REC contracts for RPS compliance only if, in the same calendar year, the LSE signs long-term bundled contracts or bundled contracts with new facilities whose aggregated annual expected deliveries[1] total at least 0.25% of its prior year's retail sales.	A primary focus of the RPS program is to build new renewable facilities until the 20% RPS goal is achieved. Limiting the use of short-term REC contracts will help maintain this objective. • Guiding principle #1: Use of REC trading for RPS compliance should be consistent with the legislative goals for the RPS program. • Guiding principle #2: REC trading should result in minimal disruption to the current RPS program. • Guiding principle # 4: REC trading should promote development of new

[1] This is different from the minimum quota framework set forth in D.07-05-028, which requires that the *total* deliveries expected from the long-term contracts and contracts with new facilities are greater than 0.25% of prior year's retail sales before short-term contracts can be signed.

ATTACHMENT E
Page 2

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

		infrastructure in CA and neighboring states for renewable energy generation.
COMPLIANCE QUESTIONS	**STRAW PROPOSAL**	**RATIONALE**
Flexible Compliance: Banking		
• Should tradable RECs have an "expiration date"? • Should RPS-obligated LSEs be able to "bank" tradable RECs without limitation as to quantity? • Should RPS-obligated LSEs be able to "bank" tradable RECs without temporal limitations? *Note: Currently, there are no temporal or quantity restrictions for banking bundled RPS contracts. Flexible compliance is tracked for each LSE in its Reporting and Compliance Spreadsheet submitted in biannual performance reports required by D.06-10-050.*	<u>Banking within WREGIS</u>[2] In order for tradable RECs to be used for RPS compliance, they must be retired[3] in WREGIS within three compliance years (including compliance year in which it was generated).[4] <u>Banking after WREGIS</u> After RECs are retired in WREGIS, they can be banked indefinitely for RPS compliance purposes. The flexible compliance for RECs and RPS bundled procurement will be tracked by the Compliance Spreadsheets submitted as part of the biannual Compliance Reports (D.06-10-050).	Banking rules can affect RPS compliance costs, incentives for building new renewable energy projects and market liquidity. Since the 20% goal, compliance rules and non-compliance penalties provide the incentives necessary to build new renewable facilities, the focus of banking rules should be lowering compliance costs and promoting market liquidity. By limiting banking to three years within the market, we address market liquidity by reducing the possibility of REC hoarding and manipulation of market supply, while still allowing several years of trading by all market participants. By allowing unlimited banking for LSEs'

[2] WREGIS is not currently set up for certificates to have expiration dates per se.
[3] "A Retirement Subaccount is used as a repository for WREGIS Certificates that the Account Holder wants to designate as Retired and remove from circulation (e.g. to demonstrate compliance with a state's RPS). Once a Certificate has been transferred into a WREGIS Retirement Subaccount, it cannot be transferred again to any other Account." (WREGIS Operating Rules, p. 6)
[4] The LSEs should create a banking Active sub-account within WREGIS to 'hold' RECs until they are retired for compliance purposes.

ATTACHMENT E
Page 3

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

		RPS compliance once RECs are retired in WREGIS, we are providing LSEs with the compliance flexibility to manage year-to-year REC price volatility and supply fluctuations. • Guiding Principles # 3: REC trading should not increase the cost of RPS compliance in the near term, and should lower the cost of RPS compliance over the longer term. • Guiding Principle #8: REC trading rules, guidelines, and policies should be simple, transparent, easily administered, uniformly applied, and equitable to all LSEs.

ATTACHMENT E
Page 4

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

COMPLIANCE QUESTIONS	STRAW PROPOSAL	RATIONALE
Flexible Compliance: Earmarking		
• Should earmarking[5] be allowed for TRECs?	No tradable RECs can be used for earmarking. No forward REC contracts can be used for earmarking.	Earmarking would create unnecessary administrative complexity since few REC contracts for new facilities will be executed in the short run. Additionally, since earmarking is a tool used to defer compliance deficits, the Commission must review the project viability of these contracts for IOUs. It would not be feasible to assess the viability of underlying energy projects that have not been submitted to the Commission.[6] • Guiding Principle #8: REC trading rules, guidelines, and policies should be simple, transparent, easily administered, uniformly applied, and equitable to all LSEs.

[5] Earmarking is a flexible compliance tool that LSEs can conditionally use to defer deficits. See D.06-10-050, Attachment A, pages 9-10.
[6] For example, if an IOU buys a REC from a trader, the Commission will not know which facility generates the energy associated with the REC.

ATTACHMENT E
Page 5

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

Treatment of Bundled[7] Contracts		
• What types of existing and future bundled RPS contracts can be unbundled for REC trading (excluding contracts pursuant to Pub. Util. Code § 399.16(a) for which no RECs will be created)?	Beginning on January 1, 2009,[8] LSEs can unbundle and sell the RECs (that are tracked in WREGIS) from currently operational RPS projects. (Once the RECs are sold, they cannot be used for RPS compliance by the selling LSE. The null power also cannot be used for RPS compliance by any LSE.) Beginning on January 1, 2009, LSEs can unbundle and sell RECs (that are tracked in WREGIS), on a forward basis, from Commission-approved RPS projects that are not yet online. (Once the RECs are sold, they cannot be used for RPS compliance by the selling LSE. The null power also can not be used for RPS compliance.) However, LSEs cannot unbundle the first year of a bundled contract if it has been set aside for RPS earmarking. • LSEs can unbundle subsequent years of an earmarked bundled	Bundled contracts cannot be unbundled before 2009 to ensure that the tracking system and reporting mechanisms are completely operational to avoid double counting. Allowing LSEs to unbundle currently bundled RPS contracts will potentially increase the market supply of RECs, facilitate market liquidity and efficiency, and thus could reduce RPS compliance costs. • Guiding Principle # 3: REC trading should not increase the cost of RPS compliance in the near term, and should lower the cost of RPS compliance over the longer term. Since the first year of earmarked contracts are being used for RPS compliance, the RECs cannot be unbundled and traded. Guiding Principle #8: REC trading rules, guidelines, and policies should be simple,

[7] A bundled RPS contract is a power purchase agreement that conveys all energy, capacity and environmental attributes to a load-serving entity.
[8] Note this modification from the straw proposal presented at the workshop.

ATTACHMENT E
Page 6

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

	contract.	transparent, easily administered, uniformly applied, and equitable to all LSEs.
Cost Recovery		
• What is the review and approval process for IOU REC contracts? *(Currently, all IOU bundled RPS contracts must be filed by advice letter. The contract review process for short-term bundled contracts is being separately developed in R.06-02-012.)* • What price evaluation mechanism should the Commission use to evaluate whether a REC contract price is reasonable? • Should the Commission establish standard terms and conditions (modifiable and/or non-modifiable) to be contained in REC contracts?	Review process: Long-term[9] REC contracts (either from a solicitation or bilateral) must be filed with the Commission by advice letter. All short-term REC contracts should follow the same approval process that is established in R.06-02-012 for short-term bundled contracts. Price evaluation criteria:[10] IOUs should solicit REC contracts in their annual renewable RFOs. As part of this process, the IOUs must modify their least cost, best fit (LCBF) evaluation methodologies to shortlist the most competitive REC contracts. The LCBF methodology should compare the benefits and costs of bundled contracts with REC transactions and evaluate them relative to the LSE's entire RPS portfolio.	Review process: The review process is consistent with existing rules. Price evaluation criteria: The competitive solicitation process should put a downward pressure on REC prices. Demand for RECs will be much greater than supply in the short term since the RPS program sets stringent goals and LSEs have not yet procured enough renewables to meet 2010 RPS targets.[11] As a result, economic analysis demonstrates that REC prices will be high, possibly floating to at least $50/REC, which is the non-compliance penalty price. This might not even be the highest price, since IOUs have an incentive to procure RECs for over $50 in order to transfer non-compliance costs from shareholders to ratepayers.

[9] Long-term contracts are ten years in duration or longer.
[10] Note the changes from the straw proposal presented at the Workshop
[11] See presentation from Day 1 of Workshop, "Tradable RECs for RPS Compliance: California Context".
URL: http://www.cpuc.ca.gov/static/energy/electric/renewableenergy/recpresentations.htm

ATTACHMENT E
Page 7

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

	A price cap will also be used to protect ratepayers from unreasonable costs. The price cap for any REC contract (short term, long term, bid into a solicitation, bilateral) is $35/REC levelized using the IOU's approved discount rate. Bilateral REC contracts are allowed also and are subject to the $35/REC levelized price cap. <u>Standard terms and conditions</u>: Each REC contract must contain a Commission-approved term identifying the RECs and their attributes transferred to the buyer. This term is not modifiable.	Large IOUs are not likely to need RECs for RPS compliance in the near term, since they have executed bundled contracts that could deliver energy for more than 20% of retail sales. (If a significant fraction of these contracts fail to deliver electricity, the situation of the large IOUs may change.) On the other hand, energy service providers (ESPs) might need RECs since they have migrating load, and long-term contracting does not fit their business model. Since short term contracts are limited, ESPs might need RECs to satisfy RPS compliance targets. Small and multi-jurisdictional utilities also might need RECs for compliance since signing long-term contracts for large quantities of energy is not feasible given their limited demand. It is not economically reasonable for a utility to buy a $50 REC. Given current bundled renewable energy and fossil energy contract prices, the combined $50/REC plus electricity price is greater than a bundled RPS contract. As a result, a $50 REC is not an effective procurement tool.

ATTACHMENT E
Page 8

Revised Energy Division Straw Proposal on REC Trading Compliance Rules

		The $35/REC price cap is set for REC procurement at least until the 20% RPS target is reached. If the supply of renewable energy increases after 20% is reached and/or if RPS rules change (*e.g.* delivery rules), then the Commission may decide to change the REC price evaluation criteria to reflect a market-driven price index. • Guiding principle #1: Use of REC trading for RPS compliance should be consistent with the legislative goals for the RPS program. • Guiding principle #2: REC trading should result in minimal disruption to the current RPS program. • Guiding Principles # 3: REC trading should not increase the cost of RPS compliance in the near term, and should lower the cost of RPS compliance over the longer term. • Guiding Principle #8: REC trading rules, guidelines, and policies should be simple, transparent, easily administered, uniformly applied, and equitable to all LSEs.

(END OF ATTACHMENT E)