STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: May 28, 2009

To: The Commission
(Meeting of June 4, 2009)

From: Pamela Loomis, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: **SB 696 (Wright) – CEQA exemptions: emission reduction credits.**
As Amended May 5, 2009

LEGISLATIVE SUBCOMMITTEE RECO: SUPPORT WITH AMENDMENTS

SUMMARY OF BILL:

This bill would provide a limited California Environmental Quality Act (CEQA) exemption for implementation of specific South Coast Air Quality Management District (SCAQMD) rules creating or providing air emission offsets from the SCAQMD's internal air emissions bank within the District's air basin. This bill would also require the California Energy Commission (CEC) to perform a needs assessment for a thermal power plant proposed to be located in the District.

SUMMARY OF SUPPORTING ARGUMENTS FOR RECOMMENDATION:

As a result of the Los Angeles Superior Court's decision, the SCAQMD is currently prohibited to issue any new air permits and has set aside thousands of air permits already issued, affecting businesses and services such as sewage treatment plants, hospitals, schools, fire and police stations, and landfill gas to energy projects. In addition, the SCAQMD cannot issue any offsets to thermal power plants, making it much more difficult to replace older power plants and permitting newer, cleaner plants to ensure compliance with the state's AB 32 green house gas (GHG) emissions reduction and renewables portfolio standard (RPS) goals. Finally, in the Los Angeles basin, pending litigation concerning SCAQMD's air permits will prevent the construction of new gas-fired generation that would have allowed some of the older power plants using once-through cooling (OTC) to retire.

The bill would address this "permit moratorium" by allowing the issuance of over a thousand pending permits that rely on the SCAQMD's internal air emissions offset bank.

Thus, the bill would help facilitate the replacement of older plants and the permitting of new, cleaner plants. In addition, the bill would enhance the Los Angeles basin's grid reliability by allowing SCAQMD to issue priority reserve credits to thermal power plants needed to meet current and future projected load needs during peak demand.

SUMMARY OF SUGGESTED AMENDMENTS:

A CEC needs assessment on power plants would be redundant with the CPUC's Long Term Procurement Plan (LTPP) process, which includes a need determination for new fossil fuel generation in the investor-owned utilities (IOUs) service territories. To address this redundancy, the bill should be amended to remove the CEC's role in determining need for new or replacement power plants and to acknowledge the current the CPUC's LTPP process.

DIVISION ANALYSIS (Energy Division):

- This bill would impose a requirement that power plants eligible for offset exemptions and Priority Reserve credits have to be approved through the CEC's needs assessment process. This bill would not exempt individual permits from CEQA, but the adoption and implementation of specific SCAQMD rules regarding air emission offsets would be exempt from CEQA.

- CEQA would not apply to adoption or implementation of rules by SCAQMD establishing offset exemptions, authorizing Priority Reserve Credits (PRC), or creating or tracking credits used for offset exemptions as long as the following are satisfied:

  - Use of best available control technology (BACT)
  - Air modeling to ensure no violation or no significant worsening of an existing violation of air standards
  - Within toxic air limits
  - Account for use of offsets in South Coast Air Quality Management Plan
  - SCAQMD rules must be submitted to EPA and approved by EPA

- For thermal power plants to obtain offsets under this bill, the following requirements would have to be satisfied:

  - Comply with BACT, air quality modeling impacts, toxic impacts, and emission levels per SCAQMD rule 1309.1
  - Enter into long term contracts with a utility or the State of California to provide electricity in southern California, south coast district, or be a municipal project serving only native load
  - SCAQMD accounts for the power plants' use of PRC as part of its State Implementation Plan with the U.S. EPA

  - SCAQMD rules must be submitted to the U.S. EPA and approved by the U.S. EPA
  - CEC conducts a needs assessment to determine if the plant is necessary to meet future energy needs in Southern California, specifically in SCAQMD
  - Power plant pays a mitigation fee for credits at a minimum cost of $92,000 per ton of PM10 (particulate matter less than 10 microns) and fees must be used to reduce pollution in areas impacted by power plant with a minimum 1/3 to be used for installation of renewable or alternative sources of energy.

- CEQA Section 15260 does allow for statutory exemptions that are granted by the legislature. This bill would incorporate all the environmental protective provisions of the SCAQMD rules. This bill is intended to support the continuance of the SCAQMD banking system.

- About half of the power plants in SCAQMD area are over 40 years old. With the proposed exemptions, this bill would facilitate the replacement of older plants and permitting of new, cleaner plants. One of the state's goals is to support renewables coming online and help achieve AB 32 compliance. The replacement plants can provide firming resources needed to support increased reliance on intermittent renewable energy. In addition, grid stability requires that a portion of the generation be located close to the load center, or that new transmission projects include sufficient capacitors close-to-load to preserve grid stability (the latter solution will be more costly, but would reduce in-basin emissions).

- This bill is in response to the Los Superior Court decision in Natural Resources Defense Council vs. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792) holding that the SCAQMD violated the requirements of CEQA in the promulgation of certain district rules which affects the CEC's ability to site power plants in the area. According to SCAQMD, both the CEC and CAISO attempted to file briefs supporting SCAQMD's process, but the court declined to receive them. The court ruled that the SCAQMD's CEQA document for their air emissions offset program was inadequate. The court ruled that the SCAQMD must assume that all offsets in the SCAQMD internal bank were actually in the air, which results in pollution.

- Due to the court decision, the SCAQMD was forced to stop issuing any permits which relied on using the District's internal offsets bank to offset air emissions. Currently, the SCAQMD is unable to issue over a thousand pending permits unless either SCAQMD can use their internal offset bank or CEQA analysis is performed on these projects. In addition, thousands of permits that were previously issued are now subject to CEQA analysis. This action will cause further delays and increase costs for already approved projects.

- Under the Federal Clean Air Act, the air districts must adopt programs to require that major, new or modified sources of contaminants which are released in an air basin

that do not meet the federal standards (non attainment air basin or area), must provide emissions offsets for their emissions increases as well as best available technology. If the source fails to apply for the credit, the SCAQMD claims the offsets as "orphan shutdowns" and deposits them in its internal air emissions bank. The SCAQMD uses these offsets to supply needed offsets for essential public services and for projects exempt from offsets under the District rules.

- In 2006, the SCAQMD amended its rules to allow power plants meeting specified requirements, and paying significant mitigation fees, to access the SCAQMD bank. This was deemed necessary because all the privately-owned PM10 credits in existence would supply less than half the needs of the three proposed power plants that have contracts with Southern California Edison. Developers of at least seven power plants totaling 4,300 MW were intending to use these rule revisions to permit their plants. (see table below)

Project Name	**MW**	**PPA or Muni**	**LCR Area**	**COD**
Canyon PP	200	Muni	LA Basin	Unknown
CPV Sentinel	850	PPA w/SCE	LA Basin/Imperial Valley	2010 / 2012
EME Walnut Creek	500	PPA w/SCE	LA Basin – Western/Barre	2013
NRG El Segundo	560	PPA w/SCE	LA Basin – Western/Barre	2012
Palmdale HPP*	570	Muni	None	2013
Vernon (SREC)**	943	Muni	LA Basin – Western/Barre	Unknown
Victorville 2 HPP*	563	Muni	None	2010

Notes/definitions:

1. *Project not located in SCAQMD, but licensing application proposed the use of PRCs.
2. **Project denotes that the SCAQMD has rejected the project for PRC consideration.
3. PPA is power purchase agreement between the generator and the IOU.
4. LCR is local capacity region.
5. COD is construction on-line date.

PROGRAM BACKGROUND:

- This bill would require the CEC to do needs assessments for new thermal power plants proposed to be located within the SCAQMD area. The CEC would have to determine that the plants are necessary for future energy needs in southern California and are necessary to be located in the District. Due to deregulation, the CEC no longer conducts this assessment statewide. SB 110 (Peace, Chapter 581, Statutes of 2000) removed the requirement that a CEC Application for Construction (AFC) decision contain an express finding that the project conform to the Integrated Assessment Need (IAN). SB 110 also removed the IAN and generation facility planning aspects from the CEC's biennial report.

- The CPUC already performs thermal power plant needs assessments for the IOUs. The IOUs resumed procurement of electricity under the authority of AB 57

(Wright, Chapter 835, Statutes of 2002), which was enacted after the state's energy crisis. AB 57 directs the CPUC to review and adopt LTPP for the IOUs, and currently the CPUC reviews and adopts IOU procurement plans with a rolling ten-year timeframe every two years. The LTPP proceeding evaluates the utilities' need for new resources and establishes rules for rate recovery of procurement transactions. Further, the CPUC adopted a Resource Adequacy (RA) framework (PU Code 380) in 2004 in order to ensure the reliability of electric service in California. All Load Serving Entities (LSEs) are required to file with the CPUC demonstrating that they have procured sufficient capacity resources including reserves needed to serve its aggregate system load on a monthly basis.

LEGISLATIVE HISTORY:

None

STATUS:

SB 696 is currently pending in the Senate Energy, Utilities and Communications Committee. No hearing date is scheduled at this time.

SUPPORT/OPPOSITION:

Support: SCAQMD (sponsor)

Opposition: None on file

STAFF CONTACTS:

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Date: May 28, 2009

BILL NUMBER: SB 696 AMENDED
BILL TEXT

AMENDED IN SENATE MAY 5, 2009
AMENDED IN SENATE APRIL 13, 2009

INTRODUCED BY Senator Wright

FEBRUARY 27, 2009

An act to add Sections 40440.12 and 40440.13 to the Health and Safety Code, relating to air quality, and declaring the urgency thereof, to take effect immediately.

LEGISLATIVE COUNSEL'S DIGEST

SB 696, as amended, Wright. Air quality: CEQA exemptions: emission reduction credits.

(1) The California Environmental Quality Act (CEQA) requires a lead agency, as defined, to prepare, or cause to be prepared, and certify the completion of, an environmental impact report (EIR) on a project that it proposes to carry out or approve that may have a significant effect on the environment or to adopt a negative declaration if it finds that the project will not have that effect. CEQA also requires a lead agency to prepare a mitigated negative declaration for a project that may have a significant effect on the environment if revisions in the project would avoid or mitigate that effect and there is no substantial evidence that the project, as revised, would have a significant effect on the environment. CEQA exempts certain specified projects from its requirements.

Under existing law, every air pollution control district or air quality management district in a federal nonattainment area for any national ambient air quality standard is required to establish by regulation, a system by which all reductions in emissions of air contaminants that are to be used to offset certain future increases in the emission of air contaminants are banked prior to use. Pursuant to this requirement the South Coast Air Quality Management District (district) promulgated various rules establishing offset exemptions, providing Priority Reserve offset credits, and creating or tracking credits used for offset exemption or Priority Reserve projects. In Natural Resources Defense Council v. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792), the superior court found the promulgation of certain of these district rules to be in violation of CEQA.

This bill would exempt from the requirements of CEQA the adoption and implementation of specified district rules, and the creation or the use of specified credits pursuant to district rules by a thermal powerplant when certain conditions are satisfied. Because a lead agency would be required to determine whether the use of the credits qualifies for an exemption, this bill would impose a state-mandated local program.

(2) Existing law requires the State Energy Resources Conservation

and Development Commission (Energy Commission) to adopt, on a biennial basis, an integrated energy policy report to include an assessment and a forecast of the need for resource additions, efficiency, and conservation that considers all aspects of energy industries and markets.

This bill would require the Energy Commission to perform a needs assessment for a thermal powerplant proposed to be located in the district.

(3) This bill would state the findings and declarations of the Legislature concerning the need for special legislation.

(4) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

(5) This bill would declare that it is to take effect immediately as an urgency statute.

Vote: 2/3. Appropriation: no. Fiscal committee: yes. State-mandated local program: yes.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. (a) The Legislature finds and declares all of the following:

(1) Because of the superior court decision in Natural Resources Defense Council v. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792) holding the South Coast Air Quality Management District (district) violated the requirements of the California Environmental Quality Act (CEQA) (Division 13 (commencing with Section 21000) of the Public Resources Code) in the promulgation of certain district rules, the district is unable to issue over a thousand pending permits that rely on the district's internal offset bank to offset emissions.

(2) The superior court decision also required the district to set aside several thousand permits that were previously issued in reliance on the district's internal offset bank. These permits have been subject to analysis performed pursuant to CEQA that the lead agency has deemed appropriate.

(3) If prompt legislative action is not taken to correct this situation, projects will be stopped from going forward or frozen in place, representing significant losses to the economy, as well as numerous well-paying jobs. The impact of approved projects not going forward will dramatically impede any economic recovery in southern California and contribute to another state deficit as a result of lower tax revenues.

(4) Affected projects include equipment replacement to reduce air emissions, plus projects for essential public services such as hospitals, schools, landfills, sewage treatment plants, renewable energy projects, and small sources, including small businesses that are unable to locate or afford credits on the open market. With time, many other similar projects will have to be placed on hold, or have their application withdrawn.

(5) The superior court decision also prohibits the district from issuing air credits from its Priority Reserve to thermal powerplants

that are needed to meet the current and future projected electricity needs of the region and to prevent blackouts during peak demand periods.

(6) Without corrective legislation, the district cannot improve air quality by allowing the existing older and higher emitting and less efficient powerplants to be replaced with new cleaner and more efficient powerplants. Fifty percent of available total power in the region is generated from powerplants that are 40 years or older.

(7) Failure to correct this problem will mean the district cannot help meet the mandates set forth in the California Global Warming Solutions Act of 2006 (Division 25.5 (commencing with Section 38500) of the Health and Safety Code) if it cannot issue permits to provide necessary peaking power to support increased reliance on renewable energy as will be required by state efforts to reduce greenhouse gases.

(b) It is therefore necessary that legislation be enacted to allow the district to resume issuing permits and to abrogate the superior court decision in Natural Resources Defense Council v. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792).

SEC. 2. Section 40440.12 is added to the Health and Safety Code, to read:

40440.12. The California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code) does not apply to either of the following:

(a) (1) The adoption or implementation of rules by the south coast district establishing offset exemptions, providing Priority Reserve credits, or creating or tracking the credits used for offset exemptions or Priority Reserve projects, if the discretionary projects that use those exemptions or credits are subject to this division or are exempt from this division pursuant to a categorical or statutory exemption and all of the following are satisfied:

(A) South coast district rule requires the use of the best available control technology, as defined in Section 40405, and air quality modeling to ensure the source will not cause a violation, or make significantly worse an existing violation, of any ambient air quality standards as defined in district rule 1303, unless exempted from modeling pursuant to district rule 1304, as amended June 14, 1996, for each new, relocated, or modified source with an emissions increase of one pound per day or greater of any air contaminant.

(B) South coast district rule prohibits the construction of any new, relocated, or modified permitted unit if the emissions of any toxic air contaminant, as listed by the district board, exceed a cumulative increase in maximum individual cancer risk at any receptor location of greater than one in one million if the permitted unit is constructed without best available control technology for toxic air contaminants, or greater than 10 in one million if the permitted unit is constructed with best available control technology for toxic air contaminants or exceeds a chronic or acute noncancer health effect hazard index of 1.0.

(C) The south coast district accounts for the use of offset credits pursuant to this subdivision as part of the district's state implementation plan submissions and demonstrates that the use of the offset credits will not interfere with attainment or maintenance of ambient air quality standards.

(D) South coast district rules 1304, 1309.1, and 1315, as

specified in this subdivision, have been submitted to the United States Environmental Protection Agency, and have not been disapproved by that agency.

(2) The exemption provided in this subdivision applies to offset exemptions pursuant to south coast district rule 1304, as amended June 14, 1996, Priority Reserve credits pursuant to south coast district rule 1309.1, as amended May 3, 2002, and the adoption and implementation of south coast district rule 1315, as adopted September 6, 2006, and readopted August 3, 2007 *, including any amendments to those rules required by the United States Environmental Protection Agency for approval* .

(3) Upon the satisfaction of conditions specified in ~~subdivision~~ *paragraph* (1), the exemption provided in this ~~paragraph~~ *subdivision* applies to all action taken pursuant to the south coast district rules specified in paragraph (2) on and after September 6, 2006.

(4) The holding in Natural Resources Defense Council v. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792) is hereby abrogated.

(5) This subdivision does not provide any exemption from the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code) for the issuance of any permit.

(b) The adoption of south coast district rule 1309.1 and the creation or use of Priority Reserve credits pursuant to south coast district rule 1309.1, as amended August 3, 2007, *including any amendments to those rules required by the United States Environmental Protection Agency for approval,* by a thermal powerplant that is subject to this division or to Chapter 6 (commencing with Section 25500) of Division 15 of the Public Resources Code if all of the following requirements are satisfied:

(1) South coast district rules include the requirements and prohibitions specified in subparagraphs (A) and (B) of paragraph (1) of subdivision (a).

(2) The thermal powerplant emissions comply with the requirements for best available control technology, air quality modeling impacts, toxic impacts, and emissions levels as specified in south coast district rule 1309.1, as amended August 3, 2007.

(3) The thermal powerplant has entered into long-term contracts with Southern California Edison Company, San Diego Gas and Electric Company, or the State of California to provide electricity in southern California, or is a powerplant owned by a local publicly owned utility that is designed and constructed not to exceed that utility's native demand load projections, or the use of the credit is otherwise allowed by the south coast district board pursuant to south coast district rule 1309.1.

(4) The south coast district accounts for the thermal powerplants' use of Priority Reserve credits pursuant to this subdivision as part of its state implementation plan submissions and demonstrates that the use will not interfere with attainment or maintenance of ambient air quality standards.

(5) South coast district rule 1309.1, as amended August 3, 2007, and south coast district rule 1315, as adopted September 6, 2006, and readopted August 3, 2007, have been submitted to the United States Environmental Protection Agency and have not been disapproved by that

agency.

(6) The State Energy Resources Conservation and Development Commission has conducted a needs assessment that has determined that the thermal powerplant is necessary to meet future energy needs in southern California or the south coast district, and has determined it is necessary for the thermal powerplant to be located in the south coast district.

(7) (A) The thermal powerplant pays a mitigation fee for the Priority Reserve offset credits obtained that shall be at a minimum the amount set forth in south coast district rule 1309.1, as amended August 3, 2007.

(B) The south coast district board may by amendment to that rule, after a public hearing, increase the fees without affecting the applicability of this paragraph.

(C) The south coast district shall, to the extent technically and economically feasible, use the mitigation fees to mitigate emissions of the relevant pollutants or its precursors in the area impacted by emissions from the thermal powerplant, with a minimum of one-third to be used for installation of renewable or alternative sources of energy. Up to 10 percent may be used by the district for administration of the mitigation program.

(8) This subdivision does not provide any exemption from the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code) or from Chapter 6 (commencing with Section 25500) of Division 15 of the Public Resources Code, for the issuance of any permit, license, or certification.

SEC. 3. Section 40440.13 is added to the Health and Safety Code, to read:

40440.13. (a) The State Energy Resources Conservation and Development Commission shall perform a needs assessment considering the issue specified in paragraph (6) of subdivision (b) of Section 40440.12 for a thermal powerplant proposed to be located in the south coast district, whether or not the thermal powerplant is subject to Chapter 6 (commencing with Section 25500) of Division 15 of the Public Resources Code.

(b) (1) For the purposes of this section, "thermal powerplant" means any stationary or floating electrical generating facility using any source of thermal energy and any facilities appurtenant to the facility. Exploratory, development, and production wells, resource transmission lines, and other related facilities used in connection with a geothermal exploratory project or a geothermal field development project are not appurtenant facilities for the purposes of this section.

(2) "Thermal powerplant" does not include any exclusively wind, hydroelectric, or solar photovoltaic electrical generating facility.

SEC. 4. The Legislature finds and declares that a special law is necessary and that a general law cannot be made applicable within the meaning of Section 16 of Article IV of the California Constitution because of unique circumstances concerning the South Coast Air Quality Management District.

SEC. 5. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because a local agency or school district has the authority to levy service charges, fees, or assessments sufficient to pay for the program or level of service mandated by this act, within the meaning of Section

17556 of the Government Code.

SEC. 6. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

Due to the court decision in Natural Resources Defense Council v. South Coast Air Quality Management District (Super. Ct. Los Angeles County, 2007, No. BS 110792), the South Coast Air Quality Management District is unable to issue over a thousand pending permits that are either exempt from offset requirements or qualified to use offset credits from the district's Priority Reserve and is required to set aside thousands of permits already issued; therefore it is necessary for this measure to take effect immediately to allow the district to issue permits in an expeditious manner and to validate previously issued permits called into question by the superior court's decision.