

State of California

Public Utilities Commission
San Francisco

MEMORANDUM

Date : September 11, 2008

**To : The Commission
(Meeting of September 18, 2008)**

From : Gretchen Dumas, PU Counsel IV

Subject : Proposition 7 – The Solar and Clean Energy Act of 2008

Recommendation: Oppose

The Staff recommends that the Commission oppose Proposition 7, primarily because it will establish an excessively rigid, and potentially dysfunctional, structure for the further development of renewable energy in California. The structure that Proposition 7 would establish would be in place for as long as 40 years, with little opportunity for revision as new technologies emerge and new regulatory policies are developed.

Specific Areas of Concern

The current regulatory framework, as embodied in the state's Renewable Portfolio Standard ("RPS") program, which is being implemented via the Commission's long-term procurement, resource adequacy and other related proceedings provides the Commission with the flexibility needed to address emerging technologies and the changing marketplace. However, the legal changes that Proposition 7 would impose would seriously interfere with, and delay the implementation of, the numerous renewable energy-related programs that the Commission is currently carrying out. Of particular note, Proposition 7 appears to exclude all renewable resources smaller than 30 megawatts ("MW"). Such smaller renewable facilities can be expected to provide a significant portion of the renewable energy that will be needed to meet the RPS, and their exclusion from the program would inevitably hinder, rather than facilitate, the accomplishment of the state's RPS goals.

Furthermore, the institutional changes that Proposition 7 would impose would, in the short term, actively disrupt and slow down our ability as a state to meet the 20% RPS goal that is currently enshrined in state law, as well as the more aggressive 33% goal that has been established as a policy of this Commission and the California Energy Commission ("CEC") and Governor Schwarzenegger, among other leading state officials. Additionally, none of the regulatory or institutional changes that Proposition 7

would make would actually facilitate the accomplishment of the state's RPS goals in any way. For example, shifting the environmental review of transmission projects from the CPUC to the CEC would not in any way reduce the timelines needed to build new transmission. The most significant source of delay in the siting of new transmission is the environmental review process, which is a legally required step regardless of whether the CEC or CPUC is the responsible agency. Another significant source of delays in the permitting of transmission projects is beyond the control of the state, and is, rather, within the purview of the federal government or of other states.

Finally, Proposition 7 would create a conflict, because under current law, the CPUC has the responsibility for siting all transmission lines, but Proposition 7 proposes to enact a law that would only transfer transmission siting responsibility for renewable energy to the CEC. Since most transmission lines carry both renewable and non-renewable electricity, it is unclear how both agencies would be able to carry out their statutory duties.

Background

Proposition 7 makes a number of changes to the State's current RPS program and the permitting of electricity generating facilities and transmission lines. Primarily, the measure:

- Establishes new, higher RPS targets for electricity providers – 40 % by 2020 and 50 % by 2025;
- Changes the cost cap provisions that limit electricity provider obligations under the RPS;
- Future amendments to Proposition 7 would require a 2/3 vote of the legislature which limits the ability of the state to respond to changes in the marketplace if a need becomes evident;
- Excludes renewable electrical sources under 30 MW from participating in the program set up by Proposition 7;
- Falsely states that it will cap rate impacts at less than 3 percent;
- Incorporates a Fast-Track Plant Approval process that could undermine environmental protections and local input;
- Changes the process for defining “Market Price of Electricity;”
- Transfers some of the CPUC's authority over the siting of transmission lines carrying renewable power from the California Public Utilities Commission (“CPUC”) to the CEC, which would be in conflict with the CPUC's statutory duties;

- Directs the use of RPS penalty revenues to construct government-owned transmission facilities;
- Changes minimum RPS contract length from 10 years to 20 years;
- Makes renewable procurement requirements enforceable on publicly-owned utilities by the CEC;
- Sets a lower penalty rate than what is currently in statute and removes the cap on the total penalty amount for failure to meet RPS requirements; and
- Transfers permitting authority over new non-thermal renewable energy power plants over 30 MW from local government to the CEC.

Discussion

1. Establishes additional, higher RPS targets for electricity providers

Current state law requires utilities and electric service providers (collectively, “electricity providers”) to increase the amount of electricity they acquire (from their own sources or purchased from others) that is generated from renewable resources, such as solar and wind power. Each electricity provider subject to the RPS, and the implementing rules that govern how renewable energy is offered in California, must increase its share of electricity generated from eligible renewable resources by at least 1 percent each year so that, by the end of 2010, 20 percent of its electricity comes from renewable sources. Also, current state policy is that by 2020, each electricity provider subject to the RPS must increase its share of electricity generated from eligible renewable resources to 33%. In contrast to this existing law and policy, Proposition 7 adds two new, higher RPS targets 40 % by 2020 and 50 % by 2025.

The scale and timeline of the targets that would be established by Proposition 7 are unrealistic, because it fails to support such a change with any assurance that transmission lines will be available to provide renewable energy to consumers or that the necessary funds will be available to assist in the development of new renewable energy technologies. It would also exclude renewable generators under 30 megawatts. Furthermore, Proposition 7 is not supported by or based on any type of feasibility or cost analysis or resource assessment.

Proposition 7’s higher generating targets may exacerbate the supply/demand imbalances which will potentially drive up the market clearing price. The Proposition's target of 50% by 2025 would increase demand for renewable energy without addressing supply-side problems such as technological limitations and other issues that are outside of the state’s control.

In the CPUC's April 2008, RPS Report to the Legislature, common project development barriers that affect many RPS projects were identified. For example, developmental barriers include: the financing of renewable generation plants; the workability of untried technologies; the siting of transmission lines outside of the jurisdiction of the State of California that are necessary to bring renewable energy (such as out-of-state wind resources) into California; the price and supply of fuel; supply limitations for wind turbines and solar panels; and overcoming the permitting problems associated with jurisdictions other than the State of California. For example, the Federal Bureau of Land Management (“BLM”), which has jurisdiction over many of the best solar resource sites, received 50 applications between January 2006 and October 2007 to construct large solar power plants. These applications total about 43,000 MW. However, BLM is struggling to figure out how to process all these applications in a timely manner and does not have anywhere near adequate staffing to address these applications. The old processes are not sufficient in this new paradigm, and it will take time for BLM to reorient its review process. Proposition 7 does not address any of these supply-side project development barriers.

2. *Changes the cost cap provisions that limit electricity provider obligations under the RPS*

Under current law an electricity provider is, in most cases, required to acquire renewable energy by paying at or under the approved market price for electricity for that energy in a given year. The CPUC may authorize rate recovery for above market costs resulting from an electricity provider's acquisition of renewable electricity if the purchase is reasonable and consistent with RPS program goals. Moreover, an electricity provider that does not acquire sufficient amounts of renewable electricity may face monetary penalties. The current RPS has an overall cap such that the sum of approved projects costs (acquired via solicitation) does not exceed the amount of above market funds available. Thus under the RPS, a given project that is particularly innovative may exceed the market price referent by more than another project and still get approved. That would not be the case under Proposition 7. By contrast, Proposition 7 provides a cost cap of 10% above the approved market price for each renewable project in order to limit the amount of potentially higher-cost renewable electricity that an electricity provider might acquire to meet its annual RPS targets.

Moreover, Proposition 7's hard and fast cost cap of 10% above the approved market price for electricity requires no finding of reasonableness and, therefore, may create an incentive for all developers to increase bids up to 10% above the approved market price for electricity. Such a result will reduce price competition, and California consumers would lose the benefit of the downward pressure on renewable energy prices that is created under the current competitive solicitation process. Proposition 7 may further increase the average price paid for renewable resources by forcing electricity providers to accept *any* bilateral contract that meets the 10% price cap without regard for need or fit. This would not only force up prices to 10% above the market price for electricity for

bilateral contracts, but could also lead to grid operation problems if the utilities are inundated with many “must take” contracts all at once.

Also, the 10% cost cap will prevent utilities from procuring newer technologies that may exceed the 10% above the approved market price for electricity. Beyond the effect it will have on more known technologies such as solar, this cost cap will preclude market-transforming technologies (such as tidal energy, and high-temperature geothermal plants, which are very expensive today but are projected to be cost-competitive in the future) from being supported. Thus, the long-term effect of the 10% cap may be to slow the development and deployment of effective but more expensive technologies.

3. *If enacted, future amendments to Proposition 7 would require a 2/3 vote of the Legislature which limits the ability of the state to respond to changes in the marketplace if a need becomes evident*

Current RPS law can be amended by a simple majority vote of the Legislature and the Governor’s signature.

Proposition 7 explicitly states that all future amendments to Proposition 7 would require a two-thirds vote of the Legislature and the Governor’s signature. This requirement represents a high barrier to changing the program that would be established by Proposition 7 and would inhibit policy makers’ ability to address any unforeseen consequences that might arise and to make incremental improvements as technologies and market conditions evolve. Thus, this provision may inhibit, rather than facilitate the achievement of RPS targets.

Furthermore, this proposition will preclude policy-makers from adopting a more integrated approach to electric resource planning. The CPUC, in coordination with the CEC and the California Independent System Operator (operates the majority of California’s wholesale power grid) (CAISO), is currently considering how to integrate RPS procurement into long term procurement planning in order to minimize cost while ensuring that the state’s Green House Gas (GHG) reduction goals are met. Such a program could facilitate the development of renewable resources while lowering the cost of procuring and developing those resources. By imposing a two-thirds vote of the Legislature to change its program, Proposition 7 will make it much more difficult to make the necessary statutory adjustments to the state’s RPS program that may be necessary to enhance its efficiency and save ratepayers from unneeded or unreasonable expenses.

4. *Excludes renewable electrical sources under 30 MW from participating in the program set up by the Proposition 7*

Under current law, many solar, hydro and biomass projects smaller than 30 MW are eligible to participate in the RPS program. However, Proposition 7 would exclude renewable electrical sources under 30 MW

Thus, if Proposition 7 were to become law, retail sellers could only satisfy their RPS targets by procuring electricity from renewable power plants that had generating capacity of over 30 MW. This would disqualify renewable power plants with generation capacities of less than 30 MW (solar, hydro and biomass) from being eligible for the RPS program, and would essentially eviscerate the state's very active and effective existing program to encourage distributed renewable generation. There is no clear rationale for limiting RPS projects to those 30 MW and larger. Smaller distributed projects may offer certain advantages to large scale projects in terms of ease of interconnection, proximity to transmission constrained load pockets, etc, that could offer significant benefits to the electrical system and California ratepayers. Proposition 7 offers no reason whatsoever for why a strict preference for large scale projects will advance renewable energy development or the interests of the state. Renewable power sources smaller than 30 MW are unlikely to survive in a market where their output cannot be counted towards the RPS benchmarks. This would, in turn, unnecessarily increase costs, as well as decrease competition and innovation in the renewable energy market and would reduce options for electricity providers as they work to satisfy their RPS targets. It would also increase the need for large transmission lines since smaller projects can often be sited close to existing load and connect to the distribution system.

It should also be noted that if Proposition 7 were to become law, by its own terms, this section of the Proposition could not be amended by statute, unless such amendments were approved by a two-thirds vote of each house of the Legislature and signed by the Governor. Therefore, the problems created by excluding solar energy and other renewable power sources under 30MW from Proposition 7's renewable program could not be changed easily or quickly.

5. Falsely states that it will cap rate impacts at less than 3 percent

Under current law, there is no cap on future rate increases related to the procurement of renewable energy. Rate increases are routinely addressed on a regular basis by the CPUC through general rate cases. Proposition 7 states, in the Purpose and Intent section, that it will "[c]ap price impacts on consumers' electricity bills at less than 3 percent." The measure, however, contains no specific provisions to implement or enforce this declaration. Furthermore it is unclear how such a cap could be feasible given the Proposition's aggressive goals to reach 50% renewables by 2025. This cost cap presumably does not take into consideration transmission costs or integration costs which are expected to rise as a percentage of renewable energy's increased costs. Thus, the stated intent of Proposition 7 to limit rate increases is intrinsically at odds with the economic realities of what it will take to achieve the renewable energy implementation goals that the proposition sets. Put another way, the 3% cost cap in Proposition 7 may actually result in less renewable energy than the amount prescribed under the existing 20% and potential 33% mandate if the cost cap is hit at a lower level of renewable penetration.

6. *Fast-tracking of power plant approval process could undermine environmental protections and local input*

Under current law, the electrical power plant siting approval process allows cities and counties who have concerns regarding local zoning, land use, and other community planning laws the opportunity to comment. However, Proposition 7 shortens the time for such comment on the initial filing of the utility to 100 days. Proposition 7 appears to provide neither a public draft of any CEC environmental review nor any public comment on that review. Also, given the complications in the adoption by cities and counties of general plans that may be in conflict with the proposed siting of a power plant in their jurisdiction, 100 days is unlikely to be enough time for general plans to be amended to allow a new, renewable resource-based power plant to be built in a given location. The CEC's decision to permit a power plant could potentially be in direct conflict with a city or county's general plan.

Furthermore, Proposition 7's fast-track permitting process could undermine environmental protections. Currently, the CEC is exempt from the provisions of California Environmental Quality Act ("CEQA"), because the Secretary of the California Resources Agency has certified that the CEC's power plant permit review process is functionally equivalent to CEQA review. Under this scheme, the CEC must determine whether a power plant project conforms to all applicable air, water quality and other regulatory standards. The 100-day comment period would also make it difficult for environmental oversight agencies like the California Air Resources Board and the state Environmental Protection Agency from thoroughly reviewing proposed projects before they are required to submit comments to the CEC. Trustee Agencies such as the California Department of Fish and Game and the California State Lands Commission, agencies with special status pursuant to CEQA, appear to have been left completely out of the Proposition 7 environmental review process.

Proposition 7 also specifies that the CEC is to issue a permit for a qualifying renewable energy plant or related facility within six months of the filing of an application. However, the CEC is not required to issue the permit within the six-month time frame if there is evidence that the facility would cause significant harm to the environment or the electrical system or in some way does not comply with applicable regulatory standards. These provisions of Proposition 7 appear to be internally contradictory

7. *Changes process for defining "Market Price of Electricity"*

Under current law, the CPUC establishes a market price for renewable electricity on an annual basis. Proposition 7 makes two major changes in how the market price of electricity is defined for purposes of implementing the RPS. First, the measure shifts the responsibility for establishing the market price from the CPUC to the CEC. Changing the process and definition for the approved market price for electricity (which was put in place after three years of litigation) would inevitably have the effect of creating confusion in the market and burdening the stakeholders with more protracted litigation. Further,

Proposition 7 offers no rationale for making this change. The current CPUC process for establishing the approved market price for electricity is robust and transparent.

Second, under current law, renewable generation under the RPS program must conform to a “least-cost best-fit” paradigm. However, Proposition 7 changes the criteria in current law that need to be considered when defining the market price of electricity. Of particular concern, is that these new criteria would no longer require consideration of environmentally friendly alternatives to above-ground transmission lines such as undergrounding transmission lines when evaluating a transmission facility that would access a solar or other renewable energy plant. This could result in the construction of unnecessary or uneconomic transmission and generation facilities. Thus, Proposition 7’s restrictions could result in the overbuilding of unneeded facilities, at ratepayer expense, and the associated potentially significant adverse environmental impacts of such unneeded facilities. Moreover, Proposition 7 could preclude the possibility of using more cost-effective options to meet energy needs.

8. *Transfers some of the CPUC’s authority over transmission to the CEC, which would be in conflict with the CPUC’s duties as articulated by current law.*

Under current law, the California Constitution authorizes the CPUC to issue permits for transmission lines proposed by investor-owned electric utilities. Proposition 7 transfers this authority for transmission lines carrying “renewable” energy to the CEC. Splitting this transmission authority on the basis of “renewable” energy is problematic. Transmission lines do not discriminate on the basis of the source of the energy being transmitted, and in fact, carry energy from both renewable and non-renewable sources. Thus, if a proposed transmission line carries both renewable energy and non-renewable energy, it is unclear which governmental agency has authority over the siting of this transmission line – and from a technical standpoint, this disconnect in the Proposition is unresolvable. Further, electrical utilities would be regulated by two governmental entities rather than one for largely the same infrastructure and the same issues using similar legal processes. This is duplication of regulatory oversight without obvious benefit. Such a conflict would likely contribute to challenges the state has faced thus far in building the necessary transmission infrastructure to access renewable generation.

9. *Directs use of penalty revenues to construct government-owned transmission lines*

Under current law, penalty monies go to the state’s General Fund. Proposition 7, however, directs that any RPS-related penalties (along with other specified revenues) be used to facilitate, through property or right-of-way acquisition and construction of transmission facilities, the development of the transmission infrastructure necessary to achieve RPS goals. The measure specifies that the CEC will hold title to any properties acquired with such funds. It is unclear how such a complex task could be implemented.

Further, if the CEC were to construct its own renewable energy generation and transmission facilities, it would place California government in direct competition with investor-owned and municipal utilities. This conflict of interest is further exacerbated by the fact that these government-owned facilities would be financed with penalty revenues that the CEC itself determines and imposes.

10. Requires renewable energy contracts to be extended to a minimum of 20 years

Under the existing program, the utilities are required to conduct request for offers (RFO) that include contract terms of 10, 15 and 20 years. Furthermore, the utilities have the opportunity to enter into shorter term contracts subject to certain limitations/requirements. By establishing contract terms of differing lengths, the utilities are able to diversify their portfolios and better manage risk to ratepayers of being locked into long-term contracts that in retrospect may look like a bad deal, if, for example renewable energy prices come down significantly. There is no compelling reason that we are aware of that would suggest 20 year contracts are required by developers or the financial community to invest in renewable projects. Further, by limiting their flexibility such an approach may, in fact, stifle competition and otherwise prove counterproductive.

11. Makes renewable procurement requirements enforceable on publicly-owned utilities by the CEC

Under current law, publicly-owned utilities set their own Renewable Energy Standards. Current law does not require publicly-owned utilities to meet the same RPS that other electricity providers are required to meet. Rather, current law directs each publicly-owned utility to put in place and enforce its own RPS and allows each publicly-owned utility to define the electricity sources that it counts as renewable. No state agency currently enforces compliance by, or places penalties on, a publicly-owned utility that fails to meet the renewable energy goals that it has set for itself.

Proposition 7 requires publicly-owned utilities to comply with the same RPS on the same terms as other electricity providers. The measure gives the CEC the enforcement authority over publicly-owned utilities. However, Proposition 7 also specifies that the CEC does not have the authority to approve or disapprove of a publicly-owned utility's renewable resources energy contract, including its terms or conditions.

12. Sets lower penalty rate in statute and removes cap on total penalty amount for failure to meet RPS requirements

Under current law, the CPUC has the authority to fine an electricity provider that fails to meet its year-to-year RPS. The CPUC has set the amount of the penalties at 5 cents per kilowatt hour by which the electricity provider falls short of its RPS target. The CPUC has capped the total amount of penalties an electricity provider can be charged in a year at \$25 million. Current law does not direct the use of these penalty monies, which generally are deposited in the state General Fund.

Proposition 7 includes a formula to determine monetary penalties for an electricity provider that fails to meet renewable energy mandates. An electricity provider that falls short of a renewable energy target will be assessed 1 cent per kilowatt hour penalty. While the proposed penalty rate is lower than that established by the CPUC, there is currently no annual cap on penalties. Thus, the measure's formula reflects a penalty rate that is dramatically lower than the 5 cents per kilowatt-hour penalty rate currently established by the CPUC. Proposition 7's penalty provisions could, thus, have the unintended consequence of giving an incentive to electricity providers not to reach their RPS targets, because the statute relaxes the penalties and codifies reasons to waive such penalties.

In addition, the measure states that no electricity provider shall recover the cost of any penalties through rates paid by its customers. It is unclear how this prohibition will apply to publicly-owned utilities which have no other source of revenue other than the rates paid by their customers.

13. Transfers permitting authority over new non-thermal renewable energy power plants over 30 MW from local government to the CEC

Under current law, local governments have this permitting authority. Proposition 7 expands the CEC's existing permitting authority by granting it the authority to permit new non-thermal renewable energy power plants capable of producing 30 MW of electricity or more. This new permitting authority would include related infrastructure, such as transmission or distribution lines that would connect the plant with the electrical grid.

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