July 16, 2010

Mr. Gary Collard
California Air Resources Board
1001 I Street, 23rd Floor
Sacramento, CA 95814

RE: Center for Resource Solutions Comments on CARB's Renewable Electricity Standard Preliminary Draft Regulation

Dear Mr. Collard,

Center for Resource Solutions ("CRS") appreciates the opportunity to provide comments on the Renewable Electricity Standard ("RES") Preliminary Draft Regulation ("PDR"), released on June 2, 2010. We commend the California Air Resources Board ("CARB") for its recognition that a 33 percent RES is crucial to achieving the greenhouse gas ("GHG") reduction goals under AB 32.

Our comment letter dated April 8, 2010, covered a range of issues. Some of these issues remain a concern for CRS. The definition for a "RES Qualifying POU Resource," found in Section 97002(a)(19), appears to establish an eligibility for REC compliance of certain generation resources, particularly hydroelectricity facilities over the existing 30 MW limit, although it does not spell out this implication. In Section 97005(c) such resources would be allowed to account for up to 20 percent of the regulated party's retail sales to end-use customers, although the ability to trade RECs from these resources is prohibited under 97005(d). CRS holds that this provision is in conflict with the stated principle of holding POUs to the same standards as IOUs, and should not be adopted. There is a likelihood that IOUs will argue for a similar flexible option for large hydro facilities, which would severely limit the development of preferred (as currently defined) eligible renewables. Should this provision be adopted, however, CRS supports the strict prohibition of trading RECs from large hydro.

Section 97004, on the timetable for compliance with the 33 percent RES, indicated as much as a four year hiatus before requiring any increase in the amount of renewable energy required above 20 percent (which is currently required by the end of 2010 under CPUC rules). CRS holds that the compliance schedule outlined in Section 97004(a) will cause great market uncertainty, as it threatens to create a four-year gap in new development or procurement of eligible RECs. Instead, CARB should assume that a 20 percent RPS will be met by 2011, and it should increase the compliance obligation in a smoother trajectory, such as a 1.5 percent increase per year, from 2011 through 2020 in order to achieve the 33 percent goal.

The remainder of this document focuses on a seemingly narrow question, with potentially broad implications, contained in the proposed Renewable Energy Credit ("REC") definition in Section 97002(a)(16). The language stating that "[a] REC does not constitute property or a property right," does not accurately reflect what RECs have been designed to do since their inception, the expectations that have evolved regarding what is embodied in RECs, the present status of various markets for RECs, or their current treatment by other State and Federal agencies.

The reality is that RECs are a property right owing to their treatment as such in common business practice, in contracts, by contractual parties, and the court system. The definition of a REC as a property right has been supported by decisions at the U.S. Environmental Protection Agency ("EPA"), the California Public Utilities Commission ("CPUC"), the Western Renewable Energy Generation Information System ("WREGIS"), and the National Association of Attorneys General.

We understand that CARB seeks to protect itself from future lawsuits that might follow inevitable regulatory adjustments, however, the proposed REC definition in Section 97002(a)(16) is unnecessary and CARB's recognition of the property rights inherent in a REC would not increase CARB's risk of a regulatory taking under the Fifth Amendment.

While this language is of little impact to CARB's risk of a future regulatory takings, the language may result in unintended, adverse consequences to the health and growth of renewables— potentially impacting over 975,000 customers nationwide.[1]

I. As Supported by the EPA, the CPUC and the WREGIS, a REC is a Property Right.

RECs constitute property rights because they are much more than a compliance tool. RECs arise out of the generation of renewable energy and, as defined by the EPA, represent the property rights to the environmental, social, and other non-power qualities of renewable energy generation. As CARB itself states, RECs may have uses "[i]n addition to the use of RECs for compliance."[2] A REC is not an allowance or authorization delivered to a party by a government agency. Rather, a REC exists independent of any regulatory mechanism that employs RECs for compliance purposes. RECs are created by the generation of renewable energy itself, regardless of the regulatory structure they may be born into. In most cases, RECs are the property of the generator, even if they are ineligible for a particular state RPS, and that generator can choose to sell RECs into one of the remaining markets, for which they may still be eligible.

Support for RECs as property already exists at the federal level. The EPA website states that a REC "represents the property rights to the environmental, social, and other nonpower qualities of renewable electricity generation."[3] The EPA also describes RECs as "the 'currency' of

[1] Lori Bird, Claire Kreycik, and Barry Friedman, *Green Power Marketing in the United States: A Status Report (2008 Data)*, National Renewable Energy Laboratory, September 2009.
[2] California Air Resources Board, Proposed Regulation for a California Renewable Energy Standard, Staff Report: Initial Statement of Reasons, June 2010, available at http://www.arb.ca.gov/regact/2010/res2010/res10isor.pdf.
[3] See http://www.epa.gov/grnpower/gpmarket/rec.htm

renewable electricity and green power markets. They can be bought and sold between multiple parties and they allow their owners to claim that renewable electricity was produced to meet the electricity demand they create."[4]

Additionally, the CPUC has stated that while a REC may not be eligible for use in certain compliance purposes such as a GHG offset, the REC still may be used for other purposes.[5] The CPUC has also articulated that distributed generation (DG) RECs are owned by the generator, acknowledging property rights in RECs through the recognition of their exclusive ownership by the party creating them.[6]

The notion that a REC constitutes more than a compliance tool and is, in fact, a property right, also enjoys support from the WREGIS "Certificate" definition.[7] This definition provides that a WREGIS Certificate "represents all Renewable and Environmental Attributes from one MWh of electricity generation from a renewable energy Generating Unit." Thus, the definition for WREGIS Certificates already includes property rights that go beyond compliance. Further, it provides that WREGIS Certificates may not necessarily be used for compliance purposes. This definition demonstrates WREGIS's recognition that a REC encompasses property rights beyond its use as a compliance instrument.

A REC constitutes personal property inclusive of rights and title to specified environmental attributes associated with a quantity of electric generation acquired from certain resources. An individual entity may possess RECs (as may be demonstrated by title to WREGIS Certificates) independently of CARB's RES program. Furthermore, as acknowledged by CARB, the WREGIS Certificates track title to environmental attributes that can be used to satisfy other regulatory programs such as California's RPS program, or other renewable programs in other jurisdictions participating in WREGIS.

Property, as defined in terms of ownership by Section 654 of the California Civil Code, "is the right of one or more persons to possess and use it to the exclusion of others."[8] The ability of individuals and businesses to own and use RECs to the exclusion of others, in voluntary markets in California and voluntary and compliance markets in other States, brings RECs squarely within the understanding of what constitutes property in California. In addition to qualifying as property under Section 654 of the California Civil Code, RECs are likely to be considered a "general intangible" under the California Commercial Code (the Uniform Commercial Code ("UCC") as adopted in the State of California). RECs are commodities representing the nonphysical attributes of renewable energy, such as avoided emissions. These key traits would seem to plainly satisfy the definition of a "general intangible" under the California Commercial Code.[9]

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[4] EPA's Green Power Partnership, *Renewable Energy Certificates*, available at http://www.epa.gov/grnpower/documents/gpp_basics-recs.pdf.

[5] See, *Decision on Definition and Attributes of Renewable Energy Credits for Compliance with the California Renewables Portfolio Standard*, D.08-08-028 (August, 2008) in CPUC Docket R.06-02-012), Appendix B, page 26.

[6] CPUC Decision 07-01-018 (conclusions of law no. 3), available at http://docs.cpuc.ca.gov/published/FINAL_DECISION/63678.htm.

[7] WREGIS, *Modified WREGIS Certificate Definition*, available at http://www.wregis.org/uploads/files/106/WREGIS%20Certificate%20modification_FINAL%2012%208%2008.pdf.

[8] West's Ann. Cal. Civ. Code § 654

[9] See California Commercial Code Section 9102(a)(42).

In short, stating that a REC does not constitute a type of property is inconsistent with notions of property in the State of California, the EPA's statements on the matter, CPUC's conclusions on this issue, and WREGIS rules pertaining to RECs.

II. CARB's Recognition of the Property Rights Inherent in RECs Would Not Increase CARB's Risk of a Regulatory Taking Under the Fifth Amendment.

RECs constitute property rights because, unlike government-created emission allowances—such as those employed in the EPA's SO_2 trading program under the Clean Air Act—they are more than a CARB-created compliance tool. Here, CARB is not granting a value or authorization but rather is administering a regulatory mechanism to ensure a 33 percent RES. Since RECs are fundamentally different than government-created emission allowances, recognition of the property rights inherent in RECs would not increase CARB's risk of a regulatory taking under the Fifth Amendment.

One reason for the language found in Section 97002(a)(16) may simply be a desire to protect CARB from potential legal challenges. Similar legal concerns were raised during the implementation of other regulatory mechanisms, such as the EPA's SO_2 cap and trade program. The RES, however, should not be subject to the same legal challenges as CARB's other regulatory mechanisms for criteria pollutants because, unlike emission allowances, RECs are created upon the generation of electricity from renewable sources and exist independent from the RES program.

The concern related to the EPA's SO_2 trading program was that, should the allowances be devalued or withdrawn from the market, allowance holders could conceivably invoke the Fifth Amendment of the U.S. Constitution if allowances were property. The Fifth Amendment prevents the taking of private property without just compensation, and has been interpreted to include regulatory takings under certain conditions.[10] The original test was laid out in *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978), which held that determining whether a regulatory taking had occurred was fact-specific and involved balancing different factors. There must be a diminution in value and a judge should consider: (a) the regulation's economic impact on the claimant; (b) the regulation's interference with distinct investment-backed expectations; and (c) the character of the governmental action. The court in *Penn Central* held that the city of New York could prevent the Grand Central Station owners from erecting a tower over the terminal as part of a comprehensive preservation scheme.

While the three factors outlined in *Penn Central* should be evaluated and balanced as a whole, it can be instructive to analyze each individual factor separately as it relates to potential claims brought by a REC owner under the RES. For each factor, the risk of a valid regulatory takings claim would not increase as a result of CARB recognizing the property rights inherent in RECs.

[10] These factors were most recently reaffirmed in *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Reg'l Planning Agency*, 216 F.3d 764, 780, 30 ELR 20638 (9th Cir. 2000).

A. Any Economic Impact to Owners of RECs, as a Result of Regulation Under RES, Would Be Mitigated by an Owners' Ability to Realize the Value of Their RECs Through the Voluntary Market and Out-of-State Compliance Programs.

In and of itself, mere diminution of economic value because of government regulation does not constitute a taking.[11] While a claimant may argue that the inability to use certain RECs for compliance under RES constitutes an adverse economic impact, this impact is mitigated by claimant's ability to sell the RECs into the approximately 24 billion kWh voluntary market or, potentially, to use the RECs for compliance purposes in other States.[12]

In analyzing whether future changes to the RES by CARB would be at risk of falling under the Takings Clause of the Fifth Amendment, it is important to note that "'[t]aking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated."[13] In other words, a REC owner would not be able to characterize future tightening of RES compliance standards as a "total taking" of the entire economic value of said owner's REC. In deciding whether a particular government action has effected a taking, courts focus, rather, on both "the character of the action and on the nature of the interference with rights in the parcel as a whole."[14] Any diminution of value resulting from the lost ability to use a REC for RES compliance purposes would have to be viewed as but one segment of the whole REC "parcel." Thus, any adverse economic impact to owners of RECs, as a result of future regulations under RES, would be minimal because owners can sell their RECs into the voluntary market or, potentially, use the RECs for compliance purposes in other States.

B. Tightening the Compliance Standards for Which RECs May Be Used Under RES Would Not Interfere with a REC Owner's Distinct Investment-Backed Expectations Because GHG Regulation in California is Expected and Planned for by REC Owners.

Governor Schwarzenegger signed AB 32, The Global Warming Solutions Act of 2006, into law almost four years ago on September 27, 2006. Participants in the renewable electricity energy industry, as well as their investment-backers, are fully aware of GHG regulations and incorporate such factors into their investment decisions and expectations. The industry-wide belief is that GHG restrictions will be tightened over time.[15] The investment-backed expectations related to renewable electricity generation, namely economic value derived from electrons and RECs, would still be intact even if certain RECs could no longer be used for compliance under RES. The electrons would still be

[11] See *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 105 (1978).
[12] Lori Bird, Claire Kreycik, and Barry Friedman, *Green Power Marketing in the United States: A Status Report (2008 Data)*, National Renewable Energy Laboratory, September 2009.
[13] See *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 105 (1978).
[14] Id. at 130.
[15] See, for example, the three full days of presentations on policy and legislation at the nation's largest energy and environment conference, EUEC 2011, available at http://www.euec.com/content/cmstemplates/euec/documents/pre-guide2010.pdf.

sold and the RECs could still be sold either into the voluntary market, which accounted for total sales of over 24 billion kWh in 2008, or potentially used for compliance purposes in other States. [16]

Even in the unlikely event that a REC owner is able to successfully argue that a tightening of the compliance standards for which RECs may be used under RES interferes with his or her distinct investment-backed expectations, the overall takings claim would likely still fail as a result of the other two factors. On balance, the nominal economic impact on the REC owner coupled with the government action motivated by public health and safety issues outweigh concerns related to frustration of investment-backed expectations.

C. Any Residual Effects to REC Owners as a Result of Regulation Under the RES Would Not Constitute a Government Taking Because CARB's Regulation Promotes Public Health and Safety and Advances a Legitimate Public Purpose.

As Section 38501(a) of the Health and Safety Code states, "[g]lobal warming poses a serious threat to the economic well-being, public health, natural resources, and the environment of California."[17] The Supreme Court has long held that the police power of a state embraces regulations designed to promote "the public health, public morals, or the public safety."[18] In confronting the immense challenges of global warming and its accompanying public health and safety hazards, it is the proper role of government to do for the people what they cannot do better for themselves. In fact, government agencies may be compelled to enact regulation in the face of public health and safety concerns related to global warming.[19] Here, pursuant to the goals of AB 32, CARB has been directed under Executive Order S-21-09 to "adopt a regulation consistent with the 33 percent renewable energy target."[20] Public health and safety have been specifically listed as the public purpose of the Global Warming Solutions Act and the regulation surrounding the proposed RES is central to achieving this purpose.

As demonstrated above, there is scant basis for applying the Takings Clause concerns of an allowance-based trading program to a program involving RECs. For these reasons, in the context of RECs used in the RES, there is little reason for concern that a court would find a regulatory taking under the Fifth Amendment. The non-property nature of government authorizations to emit pollutants (i.e., emissions allowances) must be distinguished from RECs. In contrast to government authorizations to emit pollutants, RECs include rights and benefits, independent of compliance use, that have value and may be contracted for and transferred. The ability to use a REC for a specific compliance purpose under an indentified compliance program is but one element in the bundle of rights and claims inherent in RECs. RECs not meeting California

[16] Lori Bird, Claire Kreycik, and Barry Friedman, *Green Power Marketing in the United States: A Status Report (2008 Data)*, National Renewable Energy Laboratory, September 2009.
[17] West's Ann. Cal. Health & Safety Code § 38501.
[18] See *Chicago, B. & Q. Ry. Co. v. People of State of Illinois*, 200 U.S. 561, 592 (1906); See also *Nashville, C. & St. L. Ry. v. Walters*, 294 U.S. 405, 429 (1935).
[19] See *Mass. v. EPA*, 549 U.S. 497 (2007).
[20] Executive Order S-21-09, available at http://gov.ca.gov/executive-order/13269.

requirements continue to exist and can be sold into the voluntary market or, potentially, used to comply with the requirements of another State program (e.g., Oregon's RPS). Thus, the risk of a regulatory taking under the Fifth Amendment is negligible, and it is unnecessary to state that a REC does not constitute a property right.

III. Declaring that RECs Do Not Constitute Property or Property Rights Could Incur Unintended Consequences upon Existing REC Markets and REC Market Participants.

As drafted, Section 97002(a)(16) could create market and regulatory uncertainty because the ability of parties to enforce existing and future contractual obligations and pursue remedies would be unclear. Denying the property nature of RECs would also put in jeopardy the ability of investors and lenders to obtain security interests in RECs, and investment in renewable energy could be hurt as a result.

The renewable energy market has grown significantly in recent years and, while state Renewable Portfolio Standards ("RPS") have played a role, voluntary market demand has laid claim to more renewable electricity from new generation facilities than the compliance market.[21] According to the National Renewable Energy Laboratory ("NREL"), the voluntary market grew a staggering 530 percent the years 2003 through 2008, from 3,840 GWh of sales to 24,300 GWh. The U.S. voluntary renewable energy market provides a significant revenue stream for California generators, and would allow many California consumers and businesses who support renewable energy to increase their use of renewable energy above the requirements of the RES.

REC's have been a crucial factor to the impressive growth of renewable electricity generation and the voluntary market in particular. The current trajectory of the voluntary renewable energy market depends on the ability of individuals to use long term contracts for future generation of RECs as security interests. CARB's proposed language would cause creditors to parties owning RECs to reconsider whether they will be able to perfect a security interest in a product which a California regulatory agency has determined is not property. The resulting change in present business practices would make it much more difficult for parties seeking to secure credit to pledge their RECs, through long-term off-take contracts, as collateral. The ability to secure credit at reasonable rates is critical to the growth and stability of any industry. Renewable energy is one of California's fastest growing economic sectors and CARB's failure to acknowledge the inherent property rights in RECs could be detrimental to the health of an industry vital to California's economic future.[22]

Conclusion

CRS applauds the hard work and thought that CARB staff has put into the 33 percent RES draft regulation and overall AB 32 program. However, the proposed definition for a "RES Qualifying

[21] From 2003 through 2008; new renewable generation refers to output from renewable energy projects installed after January 1st 1997 as defined by the Green-e Energy National Standard (www.Green-e.org/getcert_re_stan.shtml) and by NREL to measure voluntary market activity (www.nrel.gov/docs/fy09osti/45041.pdf).

[22] *Many Shades of Green*, Collaborative Economics and Next 10, Dec. 2009.

POU Resource" creates inequity by not holding POUs to the same standards as IOUs and would severely limit the development of preferred eligible renewables due to the use of large hydroelectricity facilities for RES compliance. CARB should also amend Section 97004(a) to eliminate the four-year gap in new development or procurement of eligible RECs and should increase the compliance obligation in a smoother trajectory in order to prevent serious market uncertainty.

In addition, the proposed language of Section 97002(a)(16) is inconsistent with the treatment of RECs by the EPA, CPUC, and WREGIS. The EPA website states that a REC "represents the property rights to the environmental, social, and other nonpower qualities of renewable electricity generation."[23] CARB's description of RECs in the Statement of Initial Reasons, the CPUC's definition of Green Attributes[24] and the definition of a WREGIS Certificate[25] recognize that RECs may be used for purposes other than compliance. Additionally, CARB's recognition of the property rights inherent in RECs would not increase its risk of a regulatory taking under the Fifth Amendment. While, conversely, CARB's proposed definition of RECs could have negative consequences for the renewable energy market and cause regulatory uncertainty surrounding RECs, which could discourage investment in new renewable generation facilities. As shown, valuable property rights in RECs already exist, and the elimination of these rights could be seen as inconsistent with the treatment of RECs by key agencies in this arena, as well as, running contrary to existing California law.

Thank you for this opportunity to contribute comments.

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[23] See EPA's Green Power Partnership, *Renewable Energy Certificates (RECs)*, available at http://www.epa.gov/grnpower/gpmarket/rec.htm.
[24] CPUC Decision 08-08-028, Appendix B, page 1, available at http://docs.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/86954.htm.
[25] WREGIS, Modified WREGIS Certificate Definition, available at http://www.wregis.org/uploads/files/106/WREGIS%20Certificate%20Definition%20modification_FINAL%2012%208%2008.pdf.