

**BEFORE THE ENERGY RESOURCES CONSERVATION AND
DEVELOPMENT COMMISSION OF THE STATE OF CALIFORNIA** **03-RPS-1078**

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Feed In Tariffs)
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Docket No. 03-RPS-1078
 RPS Proceeding

**JOINT COMMENTS OF WESTERN POWER TRADING FORUM
AND THE ALLIANCE FOR RETAIL ENERGY MARKET ON THE
CALIFORNIA FEED-IN TARIFF DESIGN AND POLICY OPTIONS REPORT**

As requested in the California Energy Commission (“Commission”) *Notice of Staff Workshop: Renewable Energy “Feed-In” Tariffs* dated December 1, 2008 (“FIT Workshop Notice”), the Western Power Trading Forum (“WPTF”)¹ and the Alliance for Retail Energy Markets (“AReM”)² respectfully submit the following comments on the Second Draft of Consultant’s Report entitled *California Feed-In Tariff Design and Policy Options Report* (“Draft Report”), and on policy issues related to the proposed expanded use of Feed-In Tariffs (“FITs”).³

I. INTRODUCTION

As stated in the FIT Workshop Notice, the Commission’s 2007 Integrated Energy Policy Report (“IEPR”) “recommended the Energy Commission collaborate with the CPUC to develop

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

² AReM is a California mutual benefit corporation whose members are electric service providers that are active in California’s direct access market. The positions taken in this filing represent the views of AReM but not necessarily those of any individual member of AReM or the affiliates of its members with respect to the issues addressed herein.

³ Constellation Energy, a member of both AReM and WPTF, has actively participated in the December 2008 CEC workshop, as well as previous CEC workshop on this topic and concurs with the comments submitted here.

a report to examine the feasibility of establishing a feed-in tariff for projects greater than 20 megawatts (MW).”⁴ In this regard, the Commission has directed the preparation of a consultant’s report, now in its second draft, *California Feed-in Tariff Design and Policy Options* (“Draft Report”), which was discussed at the Staff Workshop on December 1, 2008. The Draft Report:

- Summarizes lessons learned from the use of FITs in Europe, most notably in Germany and Spain.
- Outlines a set of core design issues that are important in the consideration of FIT policies.
- Describes a set of six potential FIT policy paths that could be adopted in California.
- Presents the interactions that FIT policy would have with other California policy frameworks, including RPS, AB 32, Competitive Renewable Energy Zones (“CREZs”), and the Public Utility Regulatory Policy Act (“PURPA”)
- Concludes with a recommendation that California should adopt a policy path that would “develop a cost-based, feed-in tariff for projects up to 20 MW that would be technology specific (each eligible technology receives a different rate compared to other technologies) and differentiated by project size,”⁵ provided that any legislative issues associated with such policy implementation can be addressed.

WPTF and AReM believe that competitive procurement rather than feed-in tariffs should remain the primary mechanism for ensuring compliance with the Renewable Portfolio Standard (“RPS”) as competition will be the driving force for innovation and downward price pressure. In these comments, WPTF and AReM recommend the following:

⁴ See FIT Workshop Notice, page 2.

⁵ See Draft Report, page 4.

- Competitive procurement reform should be the primary focus of improvements to meet the RPS, rather than an alternative procurement mechanism in the form of FITs.
- Large scale application of FITs raises difficult issues, will lead to unintended consequences, and therefore any use of FITs should remain limited in application and targeted to address specific issues with the competitive procurement process.
- If the use of FITs is expanded, specific issues need to be addressed with respect to retail choice and the utilities long term procurement planning.

II. COMPETITIVE PROCUREMENT SHOULD REMAIN THE PRIMARY MECHANISM FOR RENEWABLE PROCUREMENT

A. Competitive Procurement Provides the Most Efficient and Equitable Framework for Renewable Development

California's energy policy has been focused on maintaining reliable, cost effective, and environmentally sensitive electricity service through competitive wholesale and retail market structures. In order to promote these policies, the Commission and the California Public Utilities Commission ("CPUC") with direction from the Legislature and Governor, have focused on establishing goals and targets that market participants must achieve, and then allowing competitive market forces to determine how those goals and targets will be met. For instance, California energy policy now requires load serving entities to meet resource adequacy targets that are tied to peak load requirements; CPUC rules require the investor owned utilities ("IOUs") to meet those resource requirements primarily through competitive solicitations. Other competitive load serving entities, such as Electricity Service Providers ("ESPs") and Community Choice Aggregators ("CCAs") likewise must rely on competitive markets to secure the resources they need to meet their load serving obligations.

The same has been true with respect to renewable energy policy. Both California law and Executive Orders have set specific renewable goals that market participants are required to meet. These laws and orders, and the regulations that implement them, have not to date mandated the specific technologies or prices that should be paid for these resources. Instead, regulations to implement renewable policy have promoted competition among and within the various technologies. For instance, the Commission has implemented a comprehensive set of regulations that dictate how all renewable technologies become certified to meet the RPS. The CPUC has developed proceedings that provide guidance to the IOUs in their competitive procurement of resources.

These policies and regulations are appropriate. Achieving California's aggressive environmental goals will be no easy task; new technologies that harness renewable resources, transmission to deliver it, and mechanisms to reliably integrate it into the electric grid will require innovation and creativity. Competition to provide these technologies and services will spur these innovations, and at the same time create the downward pressure on the prices for providing them. Implementation of FITs, as recommended in the Draft Report, will not support competitive markets and thus the efficiency of a competitive paradigm will be compromised.

Moreover, competitive procurement processes provide for full consideration of the range of costs and benefits of competing technologies and services, and therefore it provides the framework that achieves least cost resource development. The transparency that accompanies competitive procurement processes provides customers with the ability to choose how they will manage the risks associated with their energy requirements, including their renewable energy obligations. Customer preferences and customers' desire to minimize their costs provide a

driving force for the competitive process to succeed. The implementation of FITs will compromise customer choice and the benefits that it brings to encouraging competition.

B. Reform is Needed to Improve RPS Procurement Effectiveness

WPTF and AReM strongly believe that the competitive framework embedded in the existing RPS is the most efficient and fair way to promote renewable development in California because it will promote innovation and least cost supply in way that FITs will not. That does not mean that the competitive RPS procurement process could not benefit from some important reforms. As noted in the Draft Report: “California is not on track to meet the 20 percent requirement” that California LSEs are obligated to achieve by 2010. Additional comments from Commissioners and other participants in the December 1 Workshop also indicated a general dissatisfaction with the RPS program results to date, and its ability to ensure that 20% of Californians’ energy use will come from eligible renewable resources by 2010, or that 33% can be achieved by 2020, as required by the recent Executive Order issued by Governor Schwarzenegger.

Reforms are needed, and WPTF and AReM strongly urge the Commission to direct their attention and influence toward those reforms, rather than on implementation of FITs. Specifically, to remedy the shortfalls in the current RPS program, the Commission should focus on changes to the existing procurement process to increase the likelihood that projects chosen for procurement will actually be built. These efforts should include evaluation of project feasibility/viability, more frequent RFOs, and reducing the time between project bid and project approval. In this manner, the success rate for projects chosen through competitive procurement will be enhanced and the risk associated with lengthy process is reduced, without upsetting the existing procurement process, or the need to pursue alternative procurement mechanisms, such as

FITs. It should also be noted that many of the problems hampering renewable development identified in the Draft Report,⁶ such as permitting, transmission, site control, community opposition and cost allocation are not resolved by FITs. Given that many of the listed challenges need to be addressed regardless of whether the commercial issues are addressed by FITs or RFO reform, WPTF and AReM strongly support a focused approach to resolving known problems with the existing structure, rather than creating further uncertainty in the renewable market and possible unintended consequences by embarking on a wholly new approach.

While WPTF and AReM certainly acknowledge a need for RFO improvement, it should be noted that the State's very ambitious renewable targets are going to require technological innovation and risk taking on new ideas. In that context, the report seems to acknowledge that FITs fall short in supporting innovative and less well established technologies. Given the State's goals, the RFO platform seems more flexible and conducive to supporting emerging technologies. In addition, the wholesale market reforms (MRTU, capacity market, ancillary services, in addition to cap and trade and tradable RECs) underway will increase the price signals, and should provide value, to guide investment in technologies that meet reliability, locational, environmental and energy demands at the lowest cost to consumers.

III. THE IMPLEMENTATION OF FITS RAISES DIFFICULT ISSUES, WILL LEAD TO UNINTENDED CONSEQUENCES, AND SHOULD THEREFORE REMAIN LIMITED TO SPECIFIC CIRCUMSTANCES

A. FITs Will Undermine Competitive Investment Policies

WPTF and AReM believe that the broad use of FITs will introduce market uncertainties that, in turn, will have a chilling effect on any renewable investment outside the FIT.

⁶ Draft Report, at p. 7.

A key element of investment decision making is an assessment of regulatory risks that market rules and/or market structures will be modified in ways that will compromise the ability of the investors to earn a reasonable return on their investments. Where those risks are perceived as significant, investment either does not occur, or is more costly as investors seek an increased return to compensate for the increased risks. A policy that allows any and all eligible renewable resources of 20 MW or less to sell their output on a must take basis at an established tariff rate will represent a new and significant risk for all renewable investors who are not entitled to such tariff rates. This is the case whether the investor intends to develop and offer its facility to the market through the utility renewable Request for Offers (“RFO”) process; it is even more acute for merchant investors that are not eligible for the FIT tariff and that have not secured a utility contract but are expecting to maximize market revenues from energy, capacity, and TREC markets.

Merchant investors rely on transparent market price signals to establish the value of their investment. However, when investment is authorized through regulatory intervention, as is the case with FITs, market price signals are undermined as the FIT “price signal” is subject to continuous regulatory adjustment and is largely unresponsive to supply and demand or other cost fundamentals. Merchant investors, who are unlikely to enter the California renewable market already because of the availability of regulatory guarantee contracts that result from the utility RFOs and that result from the ability of the IOUs to secure rate base money for renewable investments, will be even less inclined to enter a market that provides FITs. Simply put, the merchant investor will be unable to rely on market-based supply and demand fundamentals to appropriately value its resource. The outcome is that competitive markets for renewable resources are less likely to develop, and with less competitive pressure on prices, the result is

more costly development of renewable resources. Furthermore, to the extent that FITs are limited to resources under 20 MW, the out of market revenues provided to these resources will serve to undermine market revenues expected to support larger renewable resources⁷.

This inability for merchant investment to enter the market will present particular issues for ESPs. ESPs (and potentially CCAs as well) must secure products and services to meet their load obligations, including their renewable obligations, from competitive wholesale markets. If all renewable resources are committed to utility portfolios, either through the utility RFOs or FITs, ESPs will be hard pressed to structure transactions with renewable developers that provide them with the renewable energy they need to meet their share of the RPS.

Expansion of FITs will also likely have a negative impact on the utility RFOs as well; an explanation as to why rests on addressing a misstatement contained in the Draft Report. The Draft Report says that because the utilities' RPS

“solicitations have done little for generation less than 20 MW, this approach fills a perceived gap. As such, it would augment the RPS and therefore help contribute to meeting the quantity goals, accelerating the pace of development towards 33 percent by 2020 without delay.”⁸

WPTF and AReM disagree that investors in larger renewable resources will share the Draft Report's conclusion that an FIT for all facilities 20 MW or less only fills a perceived gap and does not present specific concern for developers of larger facilities. First, as proposed, the FIT would be available to all eligible resources less than 20 MW, with no cap or restriction. This will create significant risk for developers of facilities that are larger than 20 MW, especially with respect to analyzing the market risk of their investment for the time period after the utility contract expires. Moreover, the expansion of FITs will likely change that quantity of renewable

⁷ The Draft Report highlights this affect in its discussion of the Spanish market. See pp. 21-22.

⁸ See Draft Report, page 43.

resources that the utilities seek through their RFOs, which may in turn result in reduced interest in those RFOs. For these reasons, as noted in Section III.D below, the application of FITs should remain targeted to specific technology and size objectives.

B. Implementation of FITs Will Conflict With Mechanisms Being Put In Place to Support the Market-based Development of Renewable Resources, and Will Create Market Uncertainty.

While there appears to be a general consensus that renewable electricity usage in California will not reach 20% by 2010, there have nevertheless been significant strides that bode well for increased use of renewable energy in California. The list includes the introduction of Tradable Renewable Energy Credits (“TRECS”), the deployment of the CAISO’s MRTU market design, continued discussion on markets (cap-and-trade) to facilitate GHG emission reductions, enhancements to the resource adequacy program, ongoing efforts to reopen direct access to facilitate customer choice, and continued improvements to utility procurement practices. Taken together, these market initiatives are intended to re-build a competitive energy market in California to drive innovation and provide downward pressure on prices. As noted above in these comments, technological innovation and downward price pressure are both crucial for California to meet its environmental goals and maintain economic viability for its businesses. By contrast, the expansion of FITs, even if limited to facilities that are 20 MW or less, will signal to market participants that California’s commitment to competitive markets is less than robust and is subject to unwarranted and unnecessary regulatory intrusions. In fact, the Draft Report itself suggests that limiting FITs to facilities that are 20 MW or smaller need only be a temporary

restriction.⁹ In short, regulatory policies that “chip away” at the prospects for a successful competitive market design are counter-productive.

Therefore, WPTF and AReM strongly urge the Commission to allow these important competitive market reforms to work unfettered by FIT policies that will create market confusion and uncertainty.

C. The Process of Implementing FITs Will be Difficult and Likely Much Less Efficient Than Continuing to Improve the Existing RPS Program.

As noted in the introduction, the Draft Report recommends that California should adopt a policy path that would “develop a cost-based, feed-in tariff for projects up to 20 MW that would be technology specific (each eligible technology receives a different rate compared to other technologies) and differentiated by project size,”¹⁰ provided that any legislative hurdles to such policy implementation can be addressed. The process of developing tariffs that are specific for each renewable technology and that are specific for different sized facilities within each technology type will be no easy task. In fact, it is interesting (and somewhat ironic) that the Draft Report suggests that one way to develop the pricing for the FITs is to use the results of competitive solicitations and/or competitive benchmarks – the very competitive solicitations that the FIT would replace!

- Moreover, developing tariff pricing is only the tip of the iceberg with respect to implementing cost-based FITs. The Draft Report enumerates many of the other elements of an FIT, the development of which are likely to be contentious. This is

⁹ See Draft Report, page 54: “The currently recommended feed-in tariff, however, is a potential bridge for feed-in tariffs for projects larger than 20 MW. Specifically, making the recommendation to focus on renewable energy generations up to 20 MW at this time is not intended to close the door to further expanding eligibility to projects larger than 20 MW, if conditions merit expansion, as greater experience is gained through application to smaller projects, and as transmission and other barriers are addressed.”

¹⁰ See Draft Report, page 4.

demonstrated by the numerous combinations and permutations of the six different policy paths and the various issues described in Table 1¹¹ in the Executive Summary of the Draft Report which correctly note that each option must address all of the following issues: (i) which RPS policy attributes will the FIT address; (ii) what resource types will be eligible; (iii) whether the FIT is available only to new resources; (iv) what size units are eligible for FITs, (v) whether FITs are generally available or triggered only if other procurement lags behind some specific metric; (vi) whether FITs will be introduced on a large scale or as a pilot; (vii) the duration of the FIT; and (viii) where there is a cap on the quantity that is procured pursuant to the FIT.

While the Draft Report appropriately includes the above issues as ones that must be addressed in developing FITs, it omits one other key issue that must be addressed with respect to FITs, and that is whether FITs can be made available to facilities that are located outside of California but are capable of providing renewable energy and/or renewable energy credits that meet the RPS, and how transmission access issues will be resolved. This element is particularly critical given the Draft Report's recognition that many of the hurdles to California renewable development involve permitting, site control and community opposition. Those issues taken together with the higher cost of development in California suggest that a viable, long-term and cost effective renewable policy should include the ability of west wide renewable resource to serve the California market.

As noted in the preceding section, various market reforms are underway that should improve the viability of the existing RPS program, not only for large scale renewable resources,

¹¹ Table 1: Policy Paths for Further Discussion, at p. 3.

but for smaller ones as well. Nevertheless, to the extent that issues remain with respect to the difficulties that smaller facilities have in participating in the utilities' renewable RFOs, those remaining issues will be much more effectively addressed by reforming the RFO process with the reforms described in Section II.B above, rather than circumventing it entirely. In short, the problems that exist with the utility RFO process, while perhaps more acute for small renewable resources, are not at all unique to those developers. In fact, the CPUC record has clearly acknowledged the need to streamline and improve the utility RFO process to shorten the time period between the RFO issuance, and ultimate Commission approval of winning bids. Furthermore, the incentives that utilities have had to conduct less than robust RFOs for renewable facilities in order to potentially advance direct utility investment in such resources need to be addressed as well.

In summary, while the utility RFO process may need continued improvements, implementing the needed reforms will do far more to support competitive development of renewable resources, will be more consistent with other established competitive policies, and will much more efficiently improve the RPS program than will the introduction of FITs.

D. The Use of FITs Should Remain Limited to Specific Targeted Circumstances

The Draft Report details six options for FIT implementation, one of which addresses issues specific to biomass projects. This option (although not the one recommended by the authors) could represent an example of circumstances for which the limited application of FITs may be appropriate. The Draft Report notes issues of variability in biomass fuel sources, and notes limits that may be appropriate to provide sustainable generation levels. After evaluation of the potential for competitive procurement reforms for this technology, the Commission may find it would be appropriate for limited FIT application, or alternative procurement approaches.

Generally speaking, this option represents a thoughtful way to approach the expansion of FITs, through analysis of specific circumstances that warrant increased regulatory intervention, rather than broad-based adoption of FITs for all technology types.

IV. IF THE USE OF FITs IS EXPANDED, SPECIFIC ISSUES MUST BE RESOLVED QUICKLY

For all the reasons outlined above, WPTF and AReM strongly urge the Commission to limit its consideration of the expanded use of FITs. In the event this recommendation is not adopted, and the implementation of FITs is pursued, the responsible California regulatory agencies must move quickly to address the following issues so as to minimize the market uncertainty that implementation of FITs will create with respect to RPS compliance.

A. The Allocation of RPS Credit From FITs Must Be Determined.

About 8.7% of load within the IOU territories receives their electricity supply from ESPs.¹² In addition, California allows town and cities within the utilities' service areas to pursue community choice aggregation as an alternative to bundled utility service. Both ESPs and CCAs are subject to RPS mandates. In addition, they must comply with Resource Adequacy Requirements ("RAR") that have been implemented pursuant to AB 380. If FITs are adopted, and the new tariff rates become a general obligation of utility transmission and/or distribution ratepayers, customers, and their LSEs who provide their unbundled electricity supply service must be afforded their fair share of the capacity and energy from the FIT facilities. Otherwise, the customers served by ESPs and CCAs will pay twice for the capacity and energy associated with the FIT facilities – once through their transmission/distribution rates, and again through the

¹² CPUC Docket R07-05-025 is considering whether and how the reopening of Direct Access should occur in the near future.

rates they pay to ESPs and CCAs that serve them. Such a structure will, needless to say, create a severe competitive disadvantage for ESPs and CCAs. Moreover, this uncertainty about whether and how ESP and CCA customers will receive a share of the capacity and energy output from the FIT facilities will hinder their commercial activity with respect to acquisition of renewable energy to meet their RPS requirements.

B. The Impact of FITs on Utility Procurement Policies Must Be Determined.

It has been noted throughout these comments that the expanded use of FITs represents a regulatory structure that is strongly reminiscent of vertically integrated utility structures. Corollary to this concern is whether the utilities themselves, under an FIT policy, can propose to build and own facilities that are compensated through the FIT. If so, there are a number of important questions that need to be addressed, including:

- Would the FIT in this instance replace traditional rate base ownership of generating facilities?
- What is the status of the facility when the term of the FIT payments expires? Do the facilities remain in utility rate-base, or must they be accounted for otherwise?
- Would such facilities be used only to serve the utilities' bundled customers? What implications does this have for the issues raised above for ESPs and CCAs?
- How would the development of such facilities be accounted for in the utilities' biennial Long Term Procurement Planning ("LTPP") proceedings?

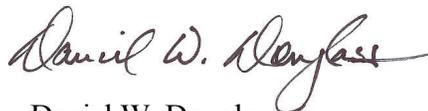
Regulatory policy in California has long been hampered by what is referred to as the "hybrid market structure" where utility ownership is expected to compete directly against independent and merchant ownership. Recent CPUC decisions have served to appropriately establish policies that limit the circumstances under which the utilities may propose and receive

approval for new utility-owned generation.¹³ Those policies are crucial to the success of the emerging competitive wholesale and retail markets. Therefore, these issues are of paramount concern to WPTF and AReM and should be fully addressed before further steps are taken to expand the use of FITs.

V. CONCLUSION

In summary, introduction of FITs will undermine, rather than complement, the existing RPS program, and therefore should not be pursued at this time. Instead, the Commission should work collaboratively with California Public Utilities Commission, the Legislature and Governor's office, and the California Independent System Operator to ensure that necessary reforms to the RPS are implemented.

Respectfully submitted,



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¹³ See, D.07-12-052 and D.08-11-004.