November 17, 2008

RENEWABLE ENERGY ALERT

CALIFORNIA VOTERS' REJECTION OF RENEWABLE ENERGY INITIATIVE BENEFITS RENEWABLE ENERGY INDUSTRY

On November 4, 2008, California voters rejected Proposition 7, a ballot initiative to expand the state's renewable portfolio standard (RPS) program and establish higher RPS targets for all electricity providers. Proposition 7 would have required all electricity providers in the state to increase their provision of renewable energy to 40 percent by 2020 and 50 percent by 2025. The ballot initiative contained substantial and potentially harmful revisions to California renewable energy law that could not be modified without a two-thirds vote of the legislature. The provisions included cost limits on renewable energy, modified regulatory structure on pricing renewable energy contracts, duplicative state-level review of new transmission facilities and lowered compliance payments for utilities unable to meet RPS targets.

While the proposition was defeated, California continues to have one of the most aggressive RPS programs in the United States. The state RPS policy left in place requires its three largest investor-owned utilities to procure 20 percent of their power from renewable energy by 2010, with state energy agencies and the governor supporting a goal of 33 percent renewable by 2020.

ROBUST OPPOSITION TO THE MEASURE

Proposition 7 was opposed by a broad coalition of utilities, environmentalists, state agencies and renewable energy developers. The opposition pointed to flaws in the legislation that would hinder and delay renewable deployment in the state.

PROPOSITION DID NOT ADDRESS SOURCES OF PROJECT DELAYS

The institutional changes that the proposition would have enacted did not address the primary sources of renewable energy project delays in the state, specifically tax uncertainty, transmission access, supply limitations for renewable technologies and developer inexperience. Instead, Proposition 7 would have disrupted the state's ability to meet existing RPS goals through the establishment of a rigid and potentially dysfunctional regulatory structure for the deployment of renewable energy. The proposition codified critical flaws that would have provided incentives to energy providers to not meet RPS goals, created new complexity in transmission facility siting and introduced pricing distortions in the renewables market.

PROPOSED CHANGES LOWERED PENALTIES FOR NONCOMPLIANCE

The penalty for failing to meet the RPS target would have been reduced to one cent per kilowatt hour, drastically lower than the current five cents per kilowatt hour penalty. This low penalty would have given electricity providers an incentive not to reach their targets. Under the current

RPS policy, utility penalties are capped at $25 million dollars per year. Proposition 7 would have removed the cap on annual penalties. However, the proposition would have codified additional reasons for state regulators to waive penalties, allowing utilities to more easily escape their compliance responsibilities.

PROPOSED DUPLICATIVE TRANSMISSION AUTHORITY

Proposition 7 would have added complexity and overlapping jurisdiction to the existing regulatory process for the siting of transmission projects. Specifically, the proposition would have shifted review for "renewable" transmission lines to the California Energy Commission, while the California Public Utilities Commission would retain jurisdiction over "nonrenewable" transmission. Because transmission lines service both renewable and nonrenewable generation, the proposition would have created an unclear and duplicative review process. The duplication of regulatory oversight for the same infrastructure does not present any obvious benefit. Moreover, a significant source of transmission permitting delays in California involves other state and federal government entities. Creating a duplicative review process for California would likely invite costly litigation and additional delay.

COUNTERPRODUCTIVE PRICING POLICIES

Proposition 7 included a renewable energy cost cap, limiting individual RPS contracts to 10 percent above market price. Such a limit would slow the development and deployment of solar and emerging market-transforming technologies that are currently priced above that cost cap. Likewise, the proposition included a "must take" incentive for electricity retailers to accept any renewable energy bilateral contract with a bid up to 10 percent above market price without review for contract reasonableness or fit. Opponents argued this provision would potentially result in price manipulation opportunities and grid instability.

REJECTION OF PROPOSITION ALLOWS FLEXIBILITY IN RENEWABLE ENERGY POLICY

Proposition 7 would have set into law a rigid new renewable energy regime that would require a two-thirds vote of the state legislature to modify. In contrast, current RPS law can be amended by a simple majority vote of the California legislature and the governor's signature. The two-thirds legislative requirement would preclude policy makers from making improvements as the renewable energy market evolves, as well as from addressing the unforeseen consequences of the proposition.

The proposition's defeat allows adjustments to the RPS program necessary to enhance state coordination and efficiency. The California energy agencies and the California Independent Systems Operator are currently considering ways to address delays of renewable energy deployment in California. Plans are underway to adopt an integrated approach to the RPS, state greenhouse gas reduction goals and long-term resource planning. Such a coordinated approach could resolve some of California's sources of project delays and potentially lower the cost of procuring and developing renewable resources.

CONTACT INFORMATION

If you have questions regarding the contents of this alert, please contact:

Richard Gittleman ....415.765.9569 ....rgittleman@akingump.com ....San Francisco
Mark Zvonkovic ....212.872.8008 ....mzvonkovic@akingump.com...............New York
Michael A. Nunes ....713.220.5879 ....tnunes@akingump.com........................Houston