PROJECT NO. 26848

PUC RULEMAKING PROCEEDING TO AMEND SUBSTANTIVE RULE §25.173, GOAL FOR RENEWABLE ENERGY	**§ § § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ADOPTING AMENDMENTS TO §25.173
AS APPROVED AT THE JANUARY 30, 2003 OPEN MEETING

The Public Utility Commission of Texas (commission) adopts an amendment to §25.173, relating to Goal for Renewable Energy, with changes to the proposed text as published in the November 22, 2002 issue of the *Texas Register* (27 TexReg 10843). The amendment extends certain deadlines related to the 2002 compliance period. Project Number 26848 is assigned to this proceeding.

Staff proposed two changes to §25.173 in response to concerns raised by various retail electric providers (REPs) about shortages and liquidity problems in the renewable energy credit (REC) market that may affect a REP's ability to meet its 2002 obligations. One change involved increasing the deficit banking allowance detailed in subsection (m). The other involved extending the compliance deadlines contained in subsection (l) by three months for the 2002 compliance period. The commission requested comments on both these proposed changes.

The commission received written comments on the proposed amendment on December 23, 2002 and January 2, 2003. Parties submitting written comments included the Alliance of

Retail Marketers (ARM), American Electric Power (AEP), Cielo Wind Power, LLC (Cielo), Occidental Power Marketing, L.P. (Occidental), Public Citizen, Reliant Resources Inc. (Reliant), Texas Wind Coalition, Virtus Energy Research Associates (Virtus), along with City Public Service of San Antonio, Austin Energy, and Environmental Defense commenting jointly (Joint Commenters). The commission also conducted a public hearing on January 6, 2003, pursuant to the Administrative Procedure Act §2001.029. Public Citizen offered oral comments at the public hearing.

The underlying issue addressed by parties was how well §25.173 was achieving the Legislature's directives for renewable energy as set forth in Public Utility Regulatory Act (PURA) §39.904, *Goal for Renewable Energy*. In this project, the commission considers the question with respect to the need for immediate changes to §25.173 that would affect settlement for the 2002 compliance period. Changes that would not affect the 2002 compliance period are being considered in Project Number 26912, *P.U.C. Project to Review of the Renewable Energy Credits Program Pursuant to §25.173*.

ARM and Occidental argued that the design of the program is flawed because the three-year life of a REC is longer than the period over which a retailer's annual REC obligation is calculated. According to these parties, the difference creates an opportunity and incentive for hoarding RECs. AEP, Cielo, Joint Commenters, Public Citizen, Texas Wind Coalition and Virtus argued that the REC program is working well and does not require any fundamental change. On the basis of comments offered in this proceeding, the commission

concludes that the proposed changes are warranted insofar as they affect the 2002 and 2003 compliance periods.

Preamble Question Number 1. This amendment would increase the rule's deficit banking allowance from 5.0% to 10% of a competitive retailer's annual REC requirement for the 2002 and 2003 compliance periods. Subsection (m)(2) contains the deficit banking provision. The commission invites specific comment on whether this change is necessary, how it would be beneficial, and on whether an amount other than 10% would be more appropriate.

ARM said adjustments to the REC rule are needed to address the disparity between buyers and sellers of RECs inadvertently created when the rule was initially adopted. ARM argued that a disparity has been created by allowing RECs to be banked for up to three years while requiring REPs to meet their annual REC allocations, creating an incentive to hoard RECs. ARM stated that this has allowed RECs to be stripped from the market and held for future years, resulting in artificial shortages. Thus, ARM asserted, despite a significant surplus of RECs available for sale in 2002, the price of RECs as of mid-November, 2002 was more than fourfold the price in May, 2002. ARM rejected arguments that competitive REPs can effectively act as sellers and noted that this fails to acknowledge the position of competitive REPs in the newly deregulated marketplace. ARM stated that, given the uncertainties in the amount of a competitive REP's load, a competitive REP is at risk if it buys forward since this would tie up capital in RECs that are not needed for current operations rather than devoting resources to maintaining and building a competitive business. ARM stated that the current

rule's banking provisions reduce flexibility by allowing RECs to be stripped from the market for hoarding and provide regulatory cover for an entity seeking to engage in economic withholding. Furthermore, ARM maintained that while the banking provisions were placed in the rule to ensure development of additional capacity, concerns about slow development of renewable resources have proven unjustified so that incentives in the ability to bank RECs do not appear to be needed. To that end, ARM recommended that the deficit banking allowance be increased from 5.0% to 100%. As an alternative, ARM said the commission should structure the deficiency allowance in a manner that will achieve greater parity between buyers and sellers of RECs over the period between now and 2007 when transmission upgrades in West Texas are anticipated to be completed. ARM recommended a deficit allowance of 85% for 2002; 70% for 2003; 55% for 2004; 40% for 2005 and 25% for 2006.

Reliant supported increasing the deficit allowance to 10% and maintaining it at a steady level until the West Texas intrazonal transmission constraints are relieved. Specifically, Reliant recommended that the commission incorporate language into the rule that allows the 10% deficit allowance to continue until the latter of 2007 or when the commission makes an affirmative determination that intrazonal transmission constraints in the West Texas zone have been eliminated. Reliant noted that this will benefit REPs by providing them flexibility in managing their annual REP obligations while the REC market matures and the transmission constraints are addressed.

Occidental said it does not object to the proposed amendment to increase the REC rule's deficit banking allowance from 5.0% to 10%. However, it objected to any further modification without addressing what it views as problems with the existing rule that has led to REC holders engaging in various "withholding equivalent" strategies to create artificial shortages of RECs with corresponding price increases.

AEP, TXU, Cielo, Texas Wind Coalition, and Public Citizen urged the commission to reject ARM's proposal and said the REC trading program is operating as the commission intended. AEP noted that the commission recognized the responsibility of each market participant to implement appropriate business planning and risk management practices to ensure that the requirement under the rule is satisfied. Thus, competitive retailers had an opportunity to implement business strategies to achieve compliance with the rule. AEP also urged the commission to reject ARM's alternative proposal of restructuring the deficiency allowance because the rule currently offers relief to those encountering REC shortfalls due to transmission constraints. In response to Reliant's proposal, AEP said that increasing the deficit allowance until transmission constraints have been addressed is unnecessary because a relief mechanism is already available for competitive retailers that encounter REC shortfalls due to transmission constraints. Specifically, subsection (o)(4) provides that a competitive retailer will not be assessed a penalty if the commission determines that events beyond the competitive retailer's control prevent it from meeting its REC obligation. Subsection (o)(5) specifies lack of transmission capacity or availability in the list of circumstances that may be outside a party's reasonable control.

TXU argued that the current REC rule has worked quite well, as more than 400 MW of renewable generation has been installed in Texas by January 1, 2003 as mandated by PURA §39.904, *Goal for Renewable Energy*. TXU noted that the rule was adopted after lengthy debate and, ultimately, compromise and agreement by the parties as to many of the rule's provisions. TXU noted that the representative from the Electric Reliability Council of Texas (ERCOT) was asked at the December 12, 2002 workshop in Project Number 26912 to quantify the number of RECs currently in existence: for the first three quarters of 2002, roughly 1.8 million RECs had been created, in addition to the roughly 600,000 RECs that had been created prior to 2002 pursuant to the early banking provisions of the rule. TXU concluded, therefore, that there currently exist approximately 2.4 million RECs, with an anticipated additional 600,000 RECs being created in the fourth quarter of 2002, and with REPs required to retire in the aggregate 1,226,400 RECs to meet their statutory obligations for 2002, this equates to roughly 2.5 times the number of RECs needed in order for the REPs, as a whole, to meet their obligations under the rule. TXU saw no reason to increase the allowance. If anything, the company said, the allowance should be eliminated entirely, although TXU said it was not arguing for elimination because parties should be able to rely on the commission's rules in developing their business plans. It said some parties may have relied upon the deficit banking provisions when deciding to make REC purchases in the past year. TXU asserted that any person can both buy and sell RECs; thus, the rule is not unfair or inequitable between sellers and buyers. TXU said that no REP at the December 12, 2002 workshop indicated that it could find no RECs to buy, that RECs had been unavailable for

purchase during 2002, or that it could not meet the provisions of the current rule, therefore the need to pay more for RECs since the spring does not reflect a need to increase the allowance. TXU said REPs that took the risk of not buying RECs earlier in 2002 at cheaper prices should not now be given regulatory relief just because their business decisions did not turn out favorably, contending that to do so would harm those REPs who took steps as necessary to ensure they would have an adequate number of RECs to comply with the current rule.

Cielo and Texas Wind Coalition opposed any changes to the current REC rule. They stated that by opening up questions about the RECs market in Texas, the commission has already destabilized the capital markets' interest in Texas wind power projects which is directly impacting the capitalization of new wind projects. Cielo urged the commission to take immediate and strong action articulating in terms that cannot be misinterpreted affirming that the REC rules are fixed and will be strictly enforced.

Texas Wind Coalition argued that intervention by the commission to defer REC obligations is a damaging precedent that signals a weakening of the state's commitment to its REC program. It asserted that no changes to the program are needed, citing the substantial surplus of RECs currently available and the relief mechanism already provided for in the rule. Instead, Texas Wind Coalition urged that the commission eliminate deficit allowances entirely since there are sufficient RECs to satisfy the collective needs of all competitive

retailers in the market and the allowance was envisioned as a special flexibility mechanism if there proved to be a shortage of RECs.

Public Citizen supported the Coalition's position and opposed any changes to the current rule, asserting that changes would undermine the nascent market for RECs. Public Citizen also argued that the fact that the commission is willing to re-open REC rules to possibly weaken them may already be undermining the value of RECs and future prices. Finally, Public Citizen indicated that there is no shortage of RECs on the market and that allegations that there is a lack of liquidity are being made to masks business decisions by certain entities to maintain a short position as to their REC obligation; in short, these entities had the same opportunities as others in the market to purchase RECs at lower prices. Public Citizen noted that there are a multitude of uncertainties and cost elements that manifest themselves in the form of REC prices and that it would be unfair to disrupt the expectations of supply and demand that formed the basis of investment in renewable technology in Texas. To this end, Public Citizen urged that a change from 5.0% to 10% in the deficit banking provision will be destabilizing, sending the wrong signals to those involved in this market.

While Joint Commenters agreed with Public Citizen, Cielo and Texas Wind Coalition that the REC program is working well, they concluded that modest changes to the rule, such as the proposed 10% deficit banking allowance, would be acceptable to provide increased flexibility for compliance without significantly altering the foundation of the rule.

With regard to the deficit banking allowance, the commission notes that support for the proposed increase to 10% was lukewarm. All commenting parties advocated either no change, a greater expansion than what was proposed, or were indifferent to the 10% allowance. The main argument put forward by advocates of a more liberal allowance was that the difference between the life of a REC (three years) and the period a retailer has to meet its obligation (one year) places retailers at an unfair disadvantage.

The three-year banking provision was intended to provide REPs with flexibility in meeting their compliance requirements, a flexibility that is necessary given the intermittent nature of renewable resources such as wind power. Moreover, this aspect of the program has been clear for three years. All retailers have operated under the same rules of the game during that time, and each has had the same opportunity to adapt to the rules – including the three-year banking provision – in whatever way is most consistent with its own business plan. The commission also recognizes that consistency of market rules is important for the smooth development of a new market. Wind developers have installed more than 1,000 MW of wind turbines in Texas, almost all of them associated with long-term contracts (i.e., 10 to 15 years). As the state's renewable energy market developed, parties priced contracts for renewable power based on the existing rules.

Although the spot market for RECs saw a price increase during the last half of 2002, it remains unclear whether it was due to program flaws as claimed by ARM or to transitory first-year market growing pangs. The commission prefers to see in Project Number 26912

further discussion of whether the three-year REC life and the annual compliance cycle together constitute a program flaw.

Reliant offered another reason to support increasing the deficit allowance: additional flexibility for REPs in managing their annual obligations while the REC market matures and transmission constraints are addressed. The commission agrees that the additional flexibility is warranted for the near-term, and agrees with Joint Commenters that the change will not undermine the structure of the rule. Whether the deficit allowance should be continued beyond 2003, however, is a longer-range question beyond the scope of this rulemaking; thus the commission prefers to consider it in Project Number 26912. The commission therefore changes the banking deficit allowance for the 2002 and 2003 compliance periods to 10%.

Preamble Question Number 2. The amendment would also add a paragraph to subsection (l) that would extend the time REPs have to comply with their 2002 REC requirements. The commission invites comment on whether or not extending the deadlines for the 2002 compliance period is necessary or would be beneficial.

TXU, AEP and ARM all supported extending the time period for 2002 compliance of the REC requirement by three months. TXU said it was unsure of the necessity but found the change beneficial, as RECs for the fourth quarter of 2002 will not be issued until March 2003. TXU also noted that REC requirements are based on actual 2002 energy sales by REPs, and that a final and accurate calculation will not be available in time for the REC

program administrator to notify each REP of its 2002 REC obligation by January 31, 2003. TXU also pointed out that this is the first compliance period, and to extend the time period would give all REPs a more than adequate period of time to verify and obtain their requirements and to retire RECs as appropriate. ARM stated that the addition will give REPs time to adjust to any changes that are made in this project. Furthermore, should changes be made to the rule under Project Number 26912, ARM said that extending the compliance schedule may allow those changes to take effect for the 2002 compliance period.

AEP suggested an additional revision that would extend the deadline of subsection (l)(1) relating to the program administrator's responsibility to notify each competitive retailer of their total REC requirement.

Texas Wind Coalition stated that the extension of the 2002 REC requirement compliance time is not needed by generators. However, since this amendment would not fundamentally alter market participant obligations, and is substantiated by an identifiable, unforeseen development (i.e., delays in ERCOT market settlement), the coalition said it would support necessary delays in the REC program settlement period.

Occidental did not object to the change, and Joint Commenters were not opposed to a 60-day extension of the annual compliance period. Similarly, these parties agreed that an extension would provide flexibility. Joint Commenters stated that it does not appear that this flexibility

would alter the economic foundation of the rule. Occidental stated this flexibility would help REPs to meet their obligation during this initial stage.

Cielo and Public Citizen opposed an extension, saying they found no problem with the design of the REC program and that a 60-day extension is therefore unnecessary and would increase uncertainty. Public Citizen found that the surplus of RECs in the market, and the fact that participants have known for almost three years that the deadline was approaching, leave no need for an extension.

TXU, in reply comments, addressed the support of proposed changes by Occidental and Joint Commenters because of their creation of additional flexibility. TXU disagreed that there is any need for additional flexibility since no REP has indicated that it will not and cannot meet the obligations of the current rule. TXU contended that there is sufficient flexibility for REPs in the current rule. TXU reiterated that it did support the 2002 compliance period extensions for the purpose of giving all REPs enough time to know, obtain and retire their actual REC obligations.

Reply comments of Reliant recognized that most parties supported a 2002 compliance period extension for lengths of time from 60-90 days. Reliant supported an extension in the 2002 compliance period of three months, citing agreement that the extension would be beneficial and ensure ample time for the accurate count of requirements by the REC program administrator, and for REPs to obtain and retire the appropriate number RECs.

The commission notes that most commenters, including some who believe the rule is working well, agreed with extending the deadlines in subsection (l), Settlement process. As noted by Texas Wind Coalition and others, of particular concern are changes in ERCOT's system-wide settlement procedures that would make the existing deadlines in this subsection problematic. The phrase "all related deadlines" of the proposed amendment would have been sufficient to apply the extension to subsection (l)(1), the deadline by which the REC Trading Program Administrator would notify each retailer of its 2002 REC requirement. Nevertheless, the commission accepts AEP's suggestion and clarifies the language of the amendment so that inclusion of paragraph (1) is unambiguous. However, the commission emphasizes that the program administrator need not wait until April 30 to notify retailers of their REC requirements and should provide this information to them as soon as it can be calculated. With respect to Cielo and Public Citizen's opposition to the extension, the commission points out that allowing additional time for compliance does not imply a problem with the REC trading program itself. ERCOT settlement issues outside the program sufficiently justify the extension.

The commission recognizes that ERCOT settlement procedures may necessitate extending the deadlines in subsection (l) permanently, but a permanent extension is beyond the scope of this proceeding. A permanent extension may be raised in Project Number 26912. In addition, the commission will discuss settlement issues with the program administrator

throughout the first half of 2003 and may consider a permanent extension of the deadlines later this year.

The commission also finds that extending the compliance schedule will provide retailers as much flexibility as a higher deficit banking allowance would have. If retailers have until June 30, 2003 to satisfy their 2002 REC requirements, the number of active RECs in the market will include those issued for the first quarter of 2003. Even though 2003-vintage RECs cannot be used for a 2002 REC obligation under §25.173, they will relieve the demand for 2002-vintage RECs that might be held as a hedge against obligations for 2003 and 2004.

The proposed deadline extensions would provide sufficient time to calculate each retailer's 2002 REC requirement, would provide retailers with more flexibility in meeting those requirements, and would help overall to achieve the Legislature's goal for renewable energy in the most efficient manner. Subsection (l) is amended as discussed herein.

All comments, including any not specifically referenced herein, were fully considered by the commission.

This amendment is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2003) (PURA), which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and, specifically PURA §15.023 which authorizes the

commission to impose an administrative penalty against a person regulated under PURA who violates PURA or a rule or order adopted under PURA; PURA §36.204 which authorizes the commission, when establishing rates for an electric utility, to provide additional incentives for renewable resources; PURA §39.101 which provides that customers are entitled to have access to providers of energy generated by renewable energy resources; and, PURA §39.904 which requires that the commission adopt rules to promote the development of renewable energy technologies.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 15.023, 39.101 and 39.904.

§25.173. Goal for Renewable Energy.

(a) **Purpose.** The purpose of this section is to ensure that an additional 2,000 megawatts (MW) of generating capacity from renewable energy technologies is installed in Texas by 2009 pursuant to the Public Utility Regulatory Act (PURA) §39.904, to establish a renewable energy credits trading program that would ensure that the new renewable energy capacity is built in the most efficient and economical manner, to encourage the development, construction, and operation of new renewable energy resources at those sites in this state that have the greatest economic potential for capture and development of this state's environmentally beneficial resources, to protect and enhance the quality of the environment in Texas through increased use of renewable resources, to respond to customers' expressed preferences for renewable resources by ensuring that all customers have access to providers of energy generated by renewable energy resources pursuant to PURA §39.101(b)(3), and to ensure that the cumulative installed renewable capacity in Texas will be at least 2,880 MW by January 1, 2009.

(b) **Application.** This section applies to power generation companies as defined in §25.5 of this title (relating to definitions), and competitive retailers as defined in subsection (c) of this section. This section shall not apply to an electric utility subject to PURA §39.102(c) until the expiration of the utility's rate freeze period.

(c) **Definitions.**

(1) **Competitive retailer —** A municipally-owned utility, generation and transmission cooperative (G&T), or distribution cooperative that offers customer choice in the restructured competitive electric power market in Texas or a retail electric provider (REP) as defined in §25.5 of this title.

(2) **Compliance period —** A calendar year beginning January 1 and ending December 31 of each year in which renewable energy credits are required of a competitive retailer.

(3) **Designated representative —** A responsible natural person authorized by the owners or operators of a renewable resource to register that resource with the program administrator. The designated representative must have the authority to represent and legally bind the owners and operators of the renewable resource in all matters pertaining to the renewable energy credits trading program.

(4) **Early banking —** Awarding renewable energy credits (RECs) to generators for sale in the trading program prior to the program's first compliance period.

(5) **Existing facilities —** Renewable energy generators placed in service before September 1, 1999.

(6) **Generation offset technology —** Any renewable technology that reduces the demand for electricity at a site where a customer consumes electricity. An example of this technology is solar water heating.

(7) **New facilities —** Renewable energy generators placed in service on or after September 1, 1999. A new facility includes the incremental capacity and associated energy from an existing renewable facility achieved through repowering activities undertaken on or after September 1, 1999.

(8) **Off-grid generation —** The generation of renewable energy in an application that is not interconnected to a utility transmission or distribution system.

(9) **Program administrator —** The entity approved by the commission that is responsible for carrying out the administrative responsibilities related to the renewable energy credits trading program as set forth in subsection (g) of this section.

(10) **REC offset (offset)** — An REC offset represents one MWh of renewable energy from an existing facility that may be used in place of an REC to meet a renewable energy requirement imposed under this section. REC offsets may not be traded, shall be calculated as set forth in subsection (i) of this section, and shall be applied as set forth in subsection (h) of this section.

(11) **Renewable energy credit (REC or credit) —** An REC represents one megawatt hour (MWh) of renewable energy that is physically metered and verified in Texas and meets the requirements set forth in subsection (e) of this section.

(12) **Renewable energy credit account (REC account) —** An account maintained by the renewable energy credits trading program administrator for

the purpose of tracking the production, sale, transfer, purchase, and retirement of RECs by a program participant.

(13) **Renewable energy credits trading program (trading program) —**The process of awarding, trading, tracking, and submitting RECs as a means of meeting the renewable energy requirements set out in subsection (d) of this section.

(14) **Renewable energy resource (renewable resource) —** A resource that produces energy derived from renewable energy technologies.

(15) **Renewable energy technology** — Any technology that exclusively relies on an energy source that is naturally regenerated over a short time and derived directly from the sun, indirectly from the sun, or from moving water or other natural movements and mechanisms of the environment. Renewable energy technologies include those that rely on energy derived directly from the sun, on wind, geothermal, hydroelectric, wave, or tidal energy, or on biomass or biomass-based waste products, including landfill gas. A renewable energy technology does not rely on energy resources derived from fossil fuels, waste products from fossil fuels, or waste products from inorganic sources.

(16) **Repowering —** Modernizing or upgrading an existing facility in order to increase its capacity or efficiency.

(17) **Settlement period —** The first calendar quarter following a compliance period in which the settlement process for that compliance year takes place.

(18) **Small producer —** A renewable resource that is less than two megawatts (MW) in size.

(d) **Renewable energy credits trading program (trading program).** Renewable energy credits may be generated, transferred, and retired by renewable energy power generators, competitive retailers, and other market participants as set forth in this section.

(1) The program administrator shall apportion a renewable resource requirement among all competitive retailers as a percentage of the retail sales of each competitive retailer as set forth in subsection (h) of this section. Each competitive retailer shall be responsible for retiring sufficient RECs as set forth in subsections (h) and (k) of this section to comply with this section. The requirement to purchase RECs pursuant to this section becomes effective on the date each competitive retailer begins serving retail electric customers in Texas.

(2) A power generating company may participate in the program and may generate RECs and buy or sell RECs as set forth in subsection (j) of this section.

(3) RECs shall be credited on an energy basis as set forth in subsection (j) of this section.

(4) Municipally-owned utilities and distribution cooperatives that do not offer customer choice are not obligated to purchase RECs. However, regardless of

whether the municipally-owned utility or distribution cooperative offers customer choice, a municipally-owned utility or distribution cooperative possessing renewable resources that meet the requirements of subsection (e) of this section may sell RECs generated by such a resource to competitive retailers as set forth in subsection (j) of this section.

(5) Except where specifically stated, the provisions of this section shall apply uniformly to all participants in the trading program.

(e) **Facilities eligible for producing RECs in the renewable energy credits trading program.** For a renewable facility to be eligible to produce RECs in the trading program it must be either a new facility or a small producer as defined in subsection (c) of this section and must also meet the requirements of this subsection:

(1) A renewable energy resource must not be ineligible under subsection (f) of this section and must register pursuant to subsection (n) of this section;

(2) The facility's above-market costs must not be included in the rates of any utility, municipally-owned utility, or distribution cooperative through base rates, a power cost recovery factor (PCRF), stranded cost recovery mechanism, or any other fixed or variable rate element charged to end users;

(3) For a renewable energy technology that requires fossil fuel, the facility's use of fossil fuel must not exceed 2.0% of the total annual fuel input on a British thermal unit (BTU) or equivalent basis;

(4) The output of the facility must be readily capable of being physically metered and verified in Texas by the program administrator. Energy from a renewable facility that is delivered into a transmission system where it is commingled with electricity from non-renewable resources can not be verified as delivered to Texas customers. A facility is not ineligible by virtue of the fact that the facility is a generation-offset, off-grid, or on-site distributed renewable facility if it otherwise meets the requirements of this section; and

(5) For a municipally owned utility operating a gas distribution system, any production or acquisition of landfill gas that is directly supplied to the gas distribution system is eligible to produce RECs based upon the conversion of the thermal energy in BTUs to electric energy in kWh using for the conversion factor the systemwide average heat rate of the gas-fired units of the combined utility's electric system as measured in BTUs per kWh.

(6) For industry-standard thermal technologies, the RECs can be earned only on the renewable portion of energy production. Furthermore, the contribution toward statewide renewable capacity megawatt goals from such facilities would be equal to the fraction of the facility's annual MWh energy output from renewable fuel multiplied by the facility's nameplate MW capacity.

(f) **Facilities not eligible for producing RECs in the renewable energy credits trading program.** A renewable facility is not eligible to produce RECs in the trading program if it is:

(1) A renewable energy capacity addition associated with an emissions reductions project described in Health and Safety Code §382.05193, that is used to satisfy the permit requirements in Health and Safety Code §382.0519;

(2) An existing facility that is not a small producer as defined in subsection (c) of this section; or

(3) An existing fossil plant that is repowered to use a renewable fuel.

(g) **Responsibilities of program administrator.** No later than June 1, 2000, the commission shall approve an independent entity to serve as the trading program administrator. At a minimum, the program administrator shall perform the following functions:

(1) Create accounts that track RECs for each participant in the trading program;

(2) Award RECs to registered renewable energy facilities on a quarterly basis based on verified meter reads;

(3) Assign offsets to competitive retailers on an annual basis based on a nomination submitted by the competitive retailer pursuant to subsection (n) of this section;

(4) Annually retire RECs that each competitive retailer submits to meet its renewable energy requirement;

(5) Retire RECs at the end of each REC's three-year life;

(6) Maintain public information on its website that provides trading program information to interested buyers and sellers of RECs;

(7) Create an exchange procedure where persons may purchase and sell RECs. The exchange shall ensure the anonymity of persons purchasing or selling RECs. The program administrator may delegate this function to an independent third party. The commission shall approve any such delegation;

(8) Make public each month the total energy sales of competitive retailers in Texas for the previous month;

(9) Perform audits of generators participating in the trading program to verify accuracy of metered production data;

(10) Allocate the renewable energy responsibility to each competitive retailer in accordance with subsection (h) of this section; and

(11) Submit an annual report to the commission. Beginning with the program's first compliance period, the program administrator shall submit a report to the commission on or before April 15 of each calendar year. The report shall contain information pertaining to renewable energy power generators and competitive retailers. At a minimum, the report shall contain:

(A) the amount of existing and new renewable energy capacity in MW installed in the state by technology type, the owner/operator of each facility, the date each facility began to produce energy, the amount of energy generated in megawatt-hours (MWh) each quarter for all capacity participating in the trading program or that was retired from service; and

(B) a listing of all competitive retailers participating in the trading program, each competitive retailer's renewable energy credit requirement, the number of offsets used by each competitive retailer, the number of credits retired by each competitive retailer, a listing of all competitive retailers that were in compliance with the REC requirement, a listing of all competitive retailers that failed to retire sufficient REC requirement, and the deficiency of each competitive retailer that failed to retire sufficient RECs to meet its REC requirement.

(h) **Allocation of REC purchase requirement to competitive retailers.** The program administrator shall allocate REC requirements among competitive retailers. Any renewable capacity that is retired before January 1, 2009 or any capacity shortfalls that arise due to purchases of RECs from out-of-state facilities shall be replaced and incorporated into the allocation methodology set forth in this subsection. Any changes to the allocation methodology to reflect replacement capacity shall occur two compliance periods after which the facility was retired or capacity shortfall occurred. The program administrator shall use the following methodology to determine the total annual REC requirement for a given year and the final REC requirement for individual competitive retailers:

(1) The total statewide REC requirement for each compliance period shall be calculated in terms of MWh and shall be equal to the renewable capacity

target multiplied by 8,760 hours per year, multiplied by the appropriate capacity conversion factor set forth in subsection (j) of this section. The renewable energy capacity targets for the compliance period beginning January 1, of the year indicated shall be:

(A) 400 MW of new resources in 2002;

(B) 400 MW of new resources in 2003;

(C) 850 MW of new resources in 2004;

(D) 850 MW of new resources 2005;

(E) 1,400 MW of new resources in 2006;

(F) 1,400 MW of new resources in 2007;

(G) 2,000 MW of new resources in 2008; and

(H) 2,000 MW of new resources in 2009 through 2019.

(2) The final REC requirement for an individual competitive retailer for a compliance period shall be calculated as follows:

(A) Each competitive retailer's preliminary REC requirement is determined by dividing its total retail energy sales in Texas by the total retail sales in Texas of all competitive retailers, and multiplying that percentage by the total statewide REC requirement for that compliance period.

(B) The adjusted REC requirement for each competitive retailer that is entitled to an offset is determined by reducing its preliminary REC requirement by the offsets to which it qualifies, as determined under subsection (i) of this section, with the maximum reduction equal to the

competitive retailer's preliminary REC requirement. The total reductions for all competitive retailers is equal to the total usable offsets for that compliance period.

(C) Each competitive retailer's final REC requirement for a compliance period shall be increased to recapture the total usable offsets calculated under subparagraph (B) of this paragraph. The additional REC requirement shall be calculated by dividing the competitive retailer's adjusted REC requirement by the total adjusted REC requirement of all competitive retailers. This fraction shall be multiplied by the total usable offsets for that compliance period and this amount shall be added to the competitive retailer's adjusted REC requirement to produce the competitive retailer's final REC requirement for the compliance period.

(i) **Nomination and calculation of REC offsets.**

(1) A REP, municipally-owned utility, G&T cooperative, distribution cooperative, or an affiliate of a REP, municipally-owned utility, or distribution cooperative, may apply offsets to meet all or a portion of its renewable energy purchase requirement, as calculated in subsection (h) of this section, only if those offsets are nominated in a filing with the commission by June 1, 2001. A G&T may nominate the combined offsets for itself and its

member distribution cooperatives upon the presentation of a resolution by its Board authorizing it to do so.

(2) The commission shall verify any designations of REC offsets and notify the program administrator of its determination by December 31, 2001.

(3) REC offsets shall be equal to the average annual MWh output of an existing resource for the years 1991-2000 or the entire life of the existing resource, whichever is less.

(4) REC offsets qualify for use in a compliance period under subsection (h) of this section only to the extent that:

(A) The resource producing the REC offset has continuously since September 1, 1999 been owned by or its output has been committed under contract to a utility, municipally-owned utility, or cooperative nominating the resource under paragraph (1) of this subsection or, if the resource has been committed under a contract that expired after September 1, 1999 and before January 1, 2002, it is owned by or its output has been committed under contract to a utility, municipally-owned utility, or cooperative on January 1, 2002; and

(B) The facility producing the REC offsets is operated and producing energy during the compliance period in a manner consistent with historic practice.

(5) If the production from a facility producing the REC offset energy ceases for any reason, the competitive retailer may no longer claim the REC offset against its REC requirement.

(j) **Calculation of capacity conversion factor.** The capacity conversion factor used by the program administrator to allocate credits to competitive retailers shall be calculated as follows:

(1) The capacity conversion factor (CCF) shall be administratively set at 35% for 2002 and 2003, the first two compliance periods of the program.

(2) During the fourth quarter of the second compliance year (2003), the CCF shall be readjusted to reflect actual generator performance data associated with all renewable resources in the trading program. The program administrator shall adjust the CCF every two years thereafter and shall:

(A) be based on all renewable energy resources in the trading program for which at least 12 months of performance data is available;

(B) represent a weighted average of generator performance;

(C) use all valid performance data that is available for each renewable resource; and

(D) ensure that the renewable capacity goals are attained.

(k) **Production and transfer of RECs.** The program administrator shall administer a trading program for renewable energy credits in accordance with the requirements of this subsection.

(1) A REC will be awarded to the owner of a renewable resource when a MWh is metered at that renewable resource. A generator producing 0.5 MWh or greater as its last unit generated should be awarded one REC on a quarterly basis. The program administrator shall record the amount of metered MWh and credit the REC account of the renewable resource that generated the energy on a quarterly basis.

(2) The transfer of RECs between parties shall be effective only when the transfer is recorded by the program administrator.

(3) The program administrator shall require that RECs be adequately identified prior to recording a transfer and shall issue an acknowledgement of the transaction to parties upon provision of adequate information. At a minimum, the following information shall be provided:

(A) identification of the parties;

(B) REC serial number, REC issue date, and the renewable resource that produced the REC;

(C) the number of RECs to be transferred; and

(D) the transaction date.

(4) A competitive retailer shall surrender RECs to the program administrator for retirement from the market in order to meet its REC allocation for a

compliance period. The program administrator will document all REC retirements annually.

(5) On or after each April 1, the program administrator will retire RECs that have not been retired by competitive retailers and have reached the end of their three-year life.

(6) The program administrator may establish a procedure to ensure that the award, transfer, and retirement of credits are accurately recorded.

(l) **Settlement process.** Beginning in January 2003, the first quarter following the compliance period shall be the settlement period during which the following actions shall occur:

(1) By January 31, the program administrator will notify each competitive retailer of its total REC requirement for the previous compliance period as determined pursuant to subsection (h) of this section.

(2) By March 31, each competitive retailer must submit credits to the program administrator from its account equivalent to its REC requirement for the previous compliance period. If the competitive retailer has insufficient credits in its account to satisfy its obligation, and this shortfall exceeds the applicable deficit allowance as set forth in subsection (m)(2) of this section, the competitive retailer is subject to the penalty provisions in subsection (o) of this section.

(3) For the 2002 compliance period, the deadlines set forth in this subsection and all related deadlines in this section shall be extended by three months.

(m) **Trading program compliance cycle**.

(1) The first compliance period shall begin on January 1, 2002 and there will be 18 consecutive compliance periods. Early banking of RECs is permissible and may commence no earlier than July 1, 2001. The program's first settlement period shall take place during the first quarter of 2003.

(2) A competitive retailer may incur a deficit allowance equal to 10% of its REC requirement in 2002 and 2003 (the first two compliance periods of the program). This 10% deficit allowance shall not apply to entities that initiate customer choice after 2003. During the first settlement period, each competitive retailer will be subject to a penalty for any REC shortfall that is greater than 10% of its REC requirement under subsection (h) of this section. During the second settlement period, each competitive retailer will be subject to the penalty process for any REC shortfall greater than 10% of the second year REC allocation. All competitive retailers incurring a 10% deficit pursuant to this subsection must make up the amount of RECs associated with the deficit in the next compliance period.

(3) The issue date of RECs created by a renewable energy resource shall coincide with the beginning of the compliance year in which the credits are generated.

All RECs shall have a life of three compliance periods, after which the program administrator will retire them from the trading program.

(4) Each REC that is not used in the year of its creation may be banked and is valid for the next two compliance years.

(5) A competitive retailer may meet its renewable energy requirements for a compliance period with RECs issued in or prior to that compliance period which have not been retired.

(n) **Registration and certification of renewable energy facilities.** The commission shall register and certify all renewable facilities that will produce either REC offsets or RECs for sale in the trading program. To be awarded RECs or REC offsets, a power generator must complete the registration process described in this subsection. The program administrator shall not award offsets or credits for energy produced by a power generator before it has been certified by the commission.

(1) The designated representative of the generating facility shall file an application with the commission on a form approved by the commission for each renewable energy generation facility. At a minimum, the application shall include the location, owner, technology, and rated capacity of the facility and shall demonstrate that the facility meets the resource eligibility criteria in subsection (e) of this section.

(2) No later than 30 days after the designated representative files the certification form with the commission, the commission shall inform both the program

administrator and the designated representative whether the renewable facility has met the certification requirements. At that time, the commission shall either certify the renewable facility as eligible to receive either RECs or offsets, or describe any insufficiencies to be remedied. If the application is contested, the time for acting is extended by 30 days.

(3) Upon receiving notice of certification of new facilities, the program administrator shall create an REC account for the designated representative of the renewable resource.

(4) The commission may make on-site visits to any certified unit of a renewable energy resource and may decertify any unit if it is not in compliance with the provisions of this subsection.

(5) A decertified renewable generator may not be awarded RECs. However, any RECs awarded by the program administrator and transferred to a competitive retailer prior to the decertification remain valid.

(o) **Penalties and enforcement.** If by April 1 of the year following a compliance year it is determined that a competitive retailer with an allocated REC purchase requirement has insufficient credits to satisfy its allocation, the competitive retailer shall be subject to the administrative penalty provisions of PURA §15.023 as specified in this subsection.

(1) Except as provided in paragraph (4) of this subsection, a penalty will be assessed for that portion of the deficient credits.

(2) The penalty shall be the lesser of $50 per MWh or, upon presentation of suitable evidence of market value by the competitive retailer, 200% of the average market value of credits for that compliance period.

(3) There will be no obligation on the competitive retailer to purchase RECs for deficits, whether or not the deficit was within or was not within the competitive retailer's reasonable control, except as set forth in subsection (m)(2) of this section.

(4) In the event that the commission determines that events beyond the reasonable control of a competitive retailer prevented it from meeting its REC requirement there will be no penalty assessed.

(5) A party is responsible for conducting sufficient advance planning to acquire its allotment of RECs. Failure of the spot or short-term market to supply a party with the allocated number of RECs shall not constitute an event outside the competitive retailer's reasonable control. Events or circumstances that are outside of a party's reasonable control may include weather-related damage, mechanical failure, lack of transmission capacity or availability, strikes, lockouts, actions of a governmental authority that adversely effect the generation, transmission, or distribution of renewable energy from an eligible resource under contract to a purchaser.

(p) **Renewable resources eligible for sale in the Texas wholesale and retail markets.** Any energy produced by a renewable resource may be bought and sold in the Texas

wholesale market or to retail customers in Texas and marketed as renewable energy if it is generated from a resource that meets the definition in subsection (c)(14) of this section.

(q) **Periodic review.** The commission shall periodically assess the effectiveness of the energy-based credits trading program in this section to maximize the energy output from the new capacity additions and ensure that the goal for renewable energy is achieved in the most economically-efficient manner. If the energy-based trading program is not effective, performance standards will be designed to ensure that the cumulative installed renewable capacity in Texas meets the requirements of PURA §39.904.

This agency hereby certifies that the rule, as adopted, has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §25.173, relating to Goal for Renewable Energy, is hereby adopted with changes to the text as proposed.

ISSUED IN AUSTIN, TEXAS ON THE 6th DAY OF FEBRUARY 2003.

PUBLIC UTILITY COMMISSION OF TEXAS

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Rebecca Klein, Chairman

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Brett A. Perlman, Commissioner

DISSENT OF COMMISSIONER PARSLEY

Commissioner Parsley respectfully dissents from the Commission vote to raise the deficit allowance for renewable energy credits described in §25.173(m)(2) from 5.0% to 10%.

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Julie Caruthers Parsley, Commissioner