SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT
The Power To Do More.SM

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November 8, 2011
LEG 2011-0633

Mr. Stuart Drown, Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

Re: SMUD Comments on the State's Coordination of Energy-Related Activities

Dear Mr. Drown:

The Sacramento Municipal Utility District (SMUD) appreciates the opportunity to provide comments to the Little Hoover Commission (LHC) on the coordination of energy-related activities in California. SMUD understands that a main focus of the LHC in this effort is progress on and barriers to the State's renewable energy goals.

SMUD's General Comments

In its 65 years of powering California's capital region, SMUD has developed a national reputation as one of the most innovative energy providers in the country. SMUD's mission is to deliver reliable, affordable electricity in an environmentally sustainable manner. SMUD is the second largest publicly-owned utility in the state, and the sixth largest publicly-owned utility in the nation, serving a population of nearly 1.5 million residents.

SMUD is an independent local agency governed by an elected Board of Directors charged with establishing policy, setting rates and monitoring SMUD's performance against identified metrics. Decisions of our Board are made in public, as required by law, with opportunity for public comment. Moreover, SMUD uses extensive communication channels to inform our customers about important decisions, programs and opportunities for public input. SMUD has an excellent track record in providing reliable electricity at low rates, and has also demonstrated leadership on environmental issues, climate change, renewable energy, and energy efficiency. As the energy landscape shifts, our 600,000 customers are depending on SMUD to continue to balance the equally important attributes of reliable service, environmental stewardship and affordable electricity.

Recognizing the importance of a low-carbon future, SMUD has actively supported renewable energy development to serve our customers as part of our long-term sustainability goal – reducing our greenhouse gas (GHG) emissions for serving retail load to 10% of our 1990 level by 2050. Policies supporting this goal include SMUD's 2010 20% renewable portfolio standard (RPS) and our 33% RPS target for 2020, adopted by our Board well before the Legislature's adoption of California's mandatory 33% by 2020 RPS. In 2010 SMUD became the first large utility in California to meet the 20% RPS target. In addition, many of SMUD's customers participate in our voluntary Greenergy program wherein customers pay a premium to have up to 100% of their electricity needs met with renewable energy, bringing our total procurement of renewable generation in 2010 to 24% of our retail sales. SMUD's renewable generation portfolio coupled with our 688 megawatt hydroelectric generation facilities in the upper American River area and a long term hydroelectric power purchase agreement with the Western Area Power Adminstration make SMUD one of the lowest GHG emitting utilities in California with more than 43% of our electricity generated from non-carbon resources.

In addition, SMUD actively supports the development of clean local distributed generation in our community. SMUD developed distributed solar programs in the 1990s with great success and continues to develop innovated programs designed to offer all customers the opportunity to take advantage of solar resources. SMUD is currently participating in the California Solar Initiative (CSI), working to add 125 megawatts of distributed solar power by 2016 as part of the State's 3,000 MW CSI goal. Currently, SMUD has installed about 30 megawatts of distributed solar generation under this program. SMUD recently implemented a Feed-In Tariff (FIT) program with 100 megawatts of FIT projects expected to come on-line by the end of 2012. Our FIT prices paid to the project developers are based on SMUD's marginal energy costs plus an adder for the environmental attributes associated with the renewable energy, rather than based on the developer's estimates of the production cost of the eligible technologies. SMUD has also developed and is expanding its SolarShares program, which is a community solar program available to customers who either cannot afford the upfront costs of on-premises solar or whose properties are not appropriate for solar facilities. Under this program, customers pay a monthly fee in exchange for a share of the output of a larger community solar system, which then offsets their electricity consumption through virtual net-metering.

Finally, SMUD continues to look to the future through our active research, demonstration, and development program which is engaged in significant projects related to emerging, clean distributed generation; innovative renewable generation resources; distributed and central storage options; understanding the impacts of these resources on the electricity grid; and examining ways to better integrate new resources into the evolving intelligent grid.

Describe the Utility's Progress Toward Helping the State Meet its Renewable Goals.

SMUD believes that the primary societal and environmental benefit associated with the development and deployment of renewable generation resources is the reduction of GHG emissions. Having taken early action to diversify our power supply portfolio to integrate renewable generation, SMUD has met our 2010 20% RPS target (24% including renewable energy associated with our Greenergy program) and is on track to achieve the 33% RPS target by 2020. SMUD's power supply procurement strategy recognizes the benefits of a diverse generation mix to address carbon reduction and mitigate market volatility. SMUD's approach focuses on procuring the most cost-effective resources that also meets our equally important goals of reliability and environmental sustainability. In addition to our highly efficient natural gas generation and hydro-electric facilities, SMUD meets its power supply needs through diverse renewable fuel sources, including intermittent resources (e.g., wind and solar) and baseload resources (e.g., geothermal, biomass, and biomethane gas).

SMUD is currently expanding our Solano wind project, more than doubling its capacity by next year to approximately 230 megawatts. More local renewable generation is on the horizon through our FIT which is expected to result in 100 megawatts of new solar energy within the next eighteen months. In addition, SMUD has contracted to procure the output of a new geothermal facility in Nevada, expected to come on-line in the next 3 years and provide up to 120 megawatts of renewable baseload energy. SMUD also sees biomethane gas playing an increasingly important role in meeting our renewable resource goals in a cost effective manner and avoiding stranding existing assets. Approximately 9% of our renewable resources are from biomethane injected into the natural gas pipeline system and designated for use at our highly efficient 500 megwatt natural gas fired Consumnes Power Plant. While avoiding methane releases into the atmosphere (which are 20 times more potent than CO_2), biomethane allows utilities to displace natural gas in existing gas fired generation and continue to make efficient use of existing assets. SMUD is actively investigating additional biomethane resources both regionally and elsewhere.

How the Cost of Implementing these Goals will be Absorbed or Passed to Customers?

SMUD's renewable resources procurement strategy is directed at procuring the lowest cost renewables available through a balance of utility ownership and third-party contracts while ensuring system reliability and achieving important environmental goals. The simple truth is that, for the foreseeable future, renewable generation is more

expensive than conventional natural gas fired generation and large hydro-electric generation resources. As a consequence, increased reliance on renewable generation will create increased cost pressures on utilities. These costs will inevitably be passed on to consumers through higher retail rates. Through early renewable procurement action, and cost reduction and efficiency measures in other operational areas, SMUD has managed to mitigate some of the cost impacts to our consumers associated with higher cost renewable resources. However, with significant new investments in renewable generation coming online in the next thirty-six months, SMUD will experience significant additional power supply costs estimated at $33 million in 2012 and approximately $70 million each year for 2013 through 2015. These additional costs translate to a 5.5% rate increase in retail rates at a time when Sacramento businesses and residents are still struggling through a down State economy and can ill-afford higher energy costs. With that said, SMUD expects that the cost impacts of renewables will partially be offset by reduced natural gas prices on the forward market which decrease SMUD's cost of generation for its natural gas fired generation resources.

Has the Experience Improved in Recent Years?

SMUD strongly supports the development and deployment of renewable resources with the ultimate goal of significantly reducing GHG emissions in California. The SMUD Board of Directors adopted policies setting metrics for increasing renewable resources and substantially reducing SMUD's carbon footprint well before the State acted. SMUD took early action toward achieving these goals by seeking to procure the most cost effective renewable resources while minimizing rate impacts to our consumers, maintaining high reliability standards and achieving our aggressive sustainability goals. With due consideration of local resource availability and benefits, SMUD did so without regard to whether the resources were located within California or in adjacent states. This initial flexibility allowed SMUD to make significant progress towards our RPS and GHG targets, while continuing to provide affordable electricity to the Sacramento region. While SMUD supports the environmental goals established by legislation, the layering-on of multiple mandates, narrowing definitions of qualified resources, increasingly proscriptive rules directed at the means for achieving the goals, and staggering complexity of the rules and processes have significantly limited SMUD's flexibility in meeting the environmental goals in a cost-effective manner. In some cases, this may threaten to negate SMUD's early action investments in renewable generation resources.

In recent years, the Legislature and regulatory agencies have enacted multiple mandates, including the 20% by 2010 and now 33% by 2020 RPS; programs to increase distributed generation such as the California Solar Initiative, Feed-In Tariff, and Net Energy Metering; programs aimed at achieving all cost-effective energy efficiency investments and demand response activities; and changes to transmission policies

aimed at facilitating renewable transmission development and to distribution system policies aimed at creating a "smart grid" distribution infrastructure. In addition, the California Air Resources Board (CARB) has moved forward with rules directed at reducing GHG emissions in the utility sector, including the recent adoption of a Cap and Trade program beginning in 2013. The Cap and Trade program establishes a declining cap on GHG emissions for the state and a "market price" for GHG permits, or "allowances." This new program is already having an upward effect on in resource prices in the electricity market.

While SMUD understands that it is too late to "un-ring the bell" with regard to the myriad of mandates, SMUD believes a much better public policy approach is for the Legislature and regulatory agencies to establish an overall goal (e.g., GHG reduction metric) and then allow utilities the flexibility to craft the best means to achieve those goals. This approach would allow utilities to customize their strategies in a manner best designed to meet the needs of consumers in a cost-effective manner, while still creating accountability for meeting the broader and important environmental goals. Instead, the State has taken a different route through layered mandates that limit flexibility and reduce the "choice set" available to utilities to meet the environmental goals. With the march to adopt new mandates limiting the definition of qualifying renewables, multiplying regulatory schemes, and complex and fractured compliance and reporting rules, costs to consumers will inevitably rise. While CARB, the Energy Commission, and the California Public Utilities Commission have often sought middle ground in an attempt to harmonize rules around mandates, there remains a breathtaking array of complex rules that often lack coordination and increase the burden and costs of compliance for utilities.

SMUD believes the market for renewable generation has matured to the point where the focus should now be on harmonizing and simplifying regulations among the State's exiting mandates to encourage cost-effective achievement of the environmental goals, rather than increasing complexity and further restricting renewable fuel source options. In particular, SMUD is alarmed by the position of some policymakers and stakeholders to sharply restrict the use of biomethane to meet RPS goals. As noted above, SMUD procures nine percent of our renewable energy from biomethane injected into the interstate natural gas pipeline system connected to California and designated for use in our Consumnes Power Plant. This process follows the procedures and structures common for importing natural gas through the same pipelines, so is well-understood, efficient and low cost. The benefits of biomethane are many. Biomethane use:

- Reduces GHG emissions by displacing natural gas while also reducing methane releases into the atmosphere.

- Optimizes the value of utility investments in existing power plants thereby avoiding stranding costly assets.

- Mitigates cost impacts to consumers through the use of a lower cost renewable resource which preserves economic benefits to local communities and helps local businesses prosper.

- Increases productive development and use of renewable resources.

- Requires no costly new transmission or other grid infrastructure improvements.

The move to restrict the use of biomethane gas as a renewable fuel source will imperil these benefits and detrimentally impact consumers.

The Need for Governance or Organizational Challenges?

As described above, the layering-on of multiple mandates managed by multiple agencies having a piece of the rulemaking and oversight role further increases the complexity and costs of meeting the State's renewable generation goals. SMUD comments on two particular areas of concern where greater conformance and coordination would benefit consumers.

Cap and Trade and RPS Conformance. The Cap and Trade structure and the 33% RPS are both newly enacted or adopted, in separate proceedings. They will be implemented by separate state agencies, and while a great deal of coordination and conformance has occurred, there are still cases where an entity obligated for the RPS can procure renewable energy in a manner allowed by the RPS and see zero change in their GHG obligation under Cap and Trade. The primary benefit of procuring renewable resources is the reduction of a utility's GHG obligation, so any procurement that does not further this goal will be disfavored by the market. This lack of conformance between the state's GHG and RPS policies limit choices for utilities and increase costs for consumers. Greater conformance should be sought as these policies are implemented to achieve a lower-cost solution for meeting both the RPS and GHG targets.

RPS Complexity. There are few pieces of legislation more complicated than the State's newly enacted 33% by 2020 RPS. The legislation not only sets ambitious goals but is highly prescriptive in its approach to achieving the goals creating multiple procurement categories with specific restrictions on the percentages of types of renewable resources in each that can be or must be procured, multiple compliance periods with multiple reporting and compliance obligations, and multiple agencies

charged with implementation and enforcement. This complexity acts to increase costs to utilities and consumers and complicate the achievement of the overarching environmental goals. While there is little that can be done about the complexity inherent in the enacted legislation, the implementing agencies should avoid exacerbating the problem by choosing wherever possible the path promoting flexibility, simplicity, harmonization of rules, and elimination of duplicative and sometimes conflicting reporting requirements. Such an approach, if followed, will inevitably provide a measure of relief to utilities and consumers.

Finally, policymakers and regulatory agencies should recognize and respect the value provided by local governing boards like SMUD's Board of Directors in balancing the need to achieve important environmental goals while at the same time ensuring affordable and reliable electricity to the communities they serve. Wherever possible, policymakers and regulatory agencies should strive to maximize the flexibility afforded to these local decision-making bodies to craft strategies and means which best meet the needs of their respective communities while remaining accountable for achievement of the ultimate environmental objectives. Where flexibility exists, SMUD has consistently demonstrated the ability to create innovative, cost-effective solutions and programs to advance environmental goals to the benefit of our consumers and the State.

Again, SMUD appreciates this opportunity to provide these comments, and looks forward to discussing these issues further on November 15, 2011.

Sincerely,

Arlen Orchard
General Counsel

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cc: Corporate Files