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Fitch: California Cap/Trade Bill Lowers Public Power Reg. Risk.

Fitch Ratings-New York-18 July 2017: California's extension of its cap-and-trade legal framework through 2030 will reduce regulatory risk for the state's public power utilities by giving greater clarity on the legal framework beyond 2020, says Fitch Ratings. This in turn will allow for better resource planning decisions.

California's public power utilities have been successful at managing the state's numerous and ambitious environmental rules by recovering higher costs from ratepayers and maintaining financial margins. We expect this trend to continue and public power credit quality to remain strong through the second decade of California's environmental transformation.

California's cap-and-trade auction platform is the largest of its type in the US. Its original goal was to set an emissions limit equivalent to 1990 levels by 2020. Regular carbon auctions began in November 2012 by introducing hard emissions caps on electricity generators and large industrial sources. The program's scope was expanded to cover transportation fuels, natural gas, propane and fossil fuels in 2015. The program included free allocations of carbon allowances in the initial years, and gradually phased those allowances out, providing utilities with a runway to downsize carbon emissions over time.

The original 2006 legislation did not address what would occur with the program beyond 2020, creating uncertainty for market participants. Utilities that expected to continue to have excess allowances after 2020 could not be certain a market would exist on which to resell those allowances. Utilities requiring more time during the transition toward cleaner generation may have needed to accelerate resource investments if the market framework was not extended.

The recently approved legislation allows for carbon allowances to be banked indefinitely, reduces the amount of carbon offsets to a maximum of 6% from 2025 to 2030, includes provisions for price ceilings, and allows for the provision of allowances to support industry efforts to comply with the law and minimize cost disruptions. The target for the extended program is to reduce state wide greenhouse gas emissions to 40% of 1990 levels by 2030.

Public power utilities owned much of the coal-fired generation when the cap-and-trade program began. Since coal-fired generation emits roughly double the amount of greenhouse gases as natural gas-fired generation, downsizing coal-fired generation became a priority. Most public power issuers sold coal-fired generation or are in the process of doing so. This includes the Navajo Generating Station (formerly owned by Los Angeles Department of Water and Power), the San Juan Generation Station (with ownership interests being divested by members of MSR Public Power) and the Southern California Public Power Authority (SCPPA) and plans to repower the Intermountain Power Project in Utah by 2026 (owned by members of SCPPA).

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Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.