

Comments of J. Aron & Company

May 4, 2012 Cap and Trade Electricity Workshop

May 11, 2012

J. Aron & Company appreciates opportunity to provide comments to the California Air Resources Board (ARB) on issues discussed at the Cap and Trade electricity workshop held on May 4, 2012. J. Aron & Company is a participant in California's electricity market and offers the following comments for ARB's consideration.

Emissions Responsibility for Electricity Imports in the CAISO Market

Several market participants have raised issues regarding the assignment of emissions to sellers into the California Independent System Operator (CAISO) market at external locations such as Palo Verde (PV) on the grounds that such locations are not physically located within California. Based on current ARB proposals, emissions responsibility for such sales would be assigned to sellers into the CAISO market. This is in contrast with sales at the same delivery location in forward bilateral markets where the emissions responsibility is assigned to the buyer as illustrated in Figure 1. This outcome is based on the use of NERC e-tags that list the seller as the Purchasing Selling Entity (PSE) in case of sales in the CAISO market and the buyer as the PSE in case of a bilateral transaction between a seller and a California Load Serving Entity (LSE).

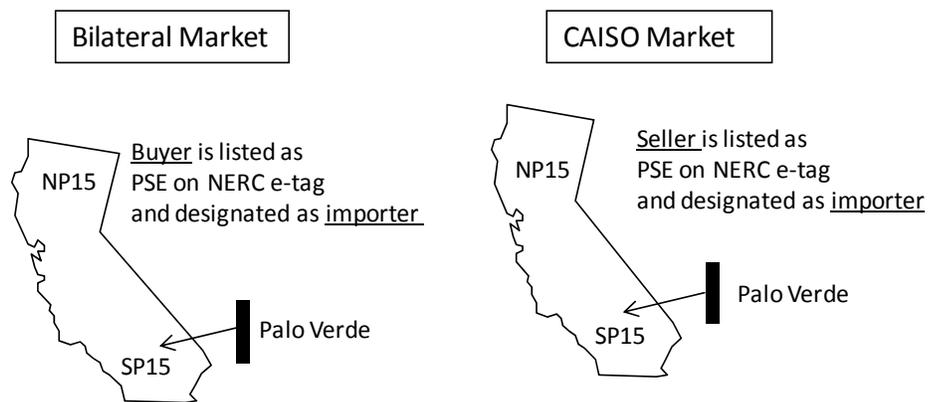


Figure 1: Emissions responsibility for sales at Palo Verde in Bilateral and CAISO markets

A guiding principle used by ARB is that imports and internal resources be treated similarly. In case of the CAISO markets, this principle takes on added significance in facilitating efficient dispatch. The assignment of emissions to electricity imports into the CAISO market is consistent with this principle. If external resources selling into the CAISO market at locations such as Palo Verde are not assigned emissions; such resources would not need to reflect a carbon premium in their offers. This could result in a less efficient external resource being dispatched ahead of a more efficient internal resource which would be contrary to the objectives of the program.

CAISO prices at external locations such as Palo Verde are produced from a Locational Marginal Price (LMP) model where the marginal resource is used to set prices across all locations, adjusted for congestion and losses. This means that prices received by imports at locations such as Palo Verde will include a carbon premium regardless of whether or not emissions are assigned to sellers. If sellers are not assigned responsibility for the emissions associated with imports, the CAISO would need to procure carbon allowances for imports and recover the costs from its customers through an uplift charge. The recovery of the uplift charge would be in addition to any carbon premium already included in the power prices for imports.

The principal argument against assigning emissions for CAISO imports to sellers is that such transactions take place at locations that are physically outside California and hence should not be subject to any California regulations. CAISO does not currently take title to power sold in its markets but operates an energy market that matches buyers and sellers. However, under recent proposals to comply with FERC Order 741, CAISO may become a central counterparty to all sales and purchases¹. A seller could then argue that title to power is transferred from the seller to the CAISO at a location outside California and that it is more appropriate for the CAISO to be responsible for the emissions. However, it is not clear what adverse impact the proposed rules might have on the seller if the assignment of emissions obligations is accompanied by the inclusion of a carbon premium in power prices. Additionally, sellers would also have the option to not sell into the CAISO market and instead make forward bilateral sales where the emission obligations would be on buyers.

Another possibility would be to make explicit in the CAISO tariff that emissions responsibility for imports will be assigned to sellers. The logic of such a proposal would be that any participant in the CAISO market must comply with the terms of the CAISO tariff. However, changes to the CAISO tariff would need to be approved by the Federal Energy Regulatory

¹ See CAISO Discussion paper on Order 741 Compliance – Central Counterparty Tariff Revisions at <http://www.caiso.com/Documents/DiscussionPaper-FERCOrder741CentralCounterpartyComplianceFiling.pdf>

Commission (FERC) and may raise other issues. It is unclear if this would necessarily be an improvement over ARB's current proposal or relying on NERC e-tags.

If a change in the assignment of emissions to sellers is contemplated, the CAISO would need to reflect the cost of procuring allowances for imports within their dispatch algorithm. This would introduce further complexity and could be time consuming to implement.

Resource Shuffling

ARB has proposed that it will be willing to provide guidance on whether specific actions constitute resource shuffling. Such guidance would be helpful for covered entities that are required to attest that they have not engaged in resource shuffling. There are other actions ARB may consider that could help address concerns about submitting such attestations. For example, entities that only claim default emissions could be granted a waiver from making such attestations. Alternatively, ARB could provide guidance on what specific activities would be of concern for an entity that is only seeking to claim default emissions for imports. Resource shuffling could also be defined more narrowly to include only those transactions that have the *sole* intent of lowering emissions obligations without an actual reduction in emissions and without any other business purpose.

The resource shuffling restriction results from the cap and trade program being limited to California and recognizing that California is part of the larger Western grid. The objective of this restriction is to prevent contractual re-arrangements involving existing resources within the Western grid that would reduce the emissions profile of California imports but yet not change overall emissions in the Western grid. However, commercial transactions between parties can change over time and such changes will inevitably lead to changes in emissions profiles. The resource shuffling restriction or uncertainty in its interpretation should not preclude legitimate commercial transactions just because they result in a lower emissions profile.

For questions or follow-up discussion, please contact Harry Singh at (212) 357-6449, or via e-mail at harry.singh@gs.com. Thank you for your consideration of these comments.

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