LS POWER ASSOCIATES, L.P.
c/o LS Power Development, LLC
5000 Hopyard Road, Suite 480
Pleasanton, CA 94588
Tel: (925) 201-5253 · Fax: (925) 201-5230

September 27, 2011

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, California 95814

Subject: Comments of LS Power on September 12, 2011 Revisions to the Cap-and-Trade Regulation

Dear Clerk:

LS Power offers the following comments on the California Air Resources Board ("CARB") September 12, 2011 Notice of Availability of Modified Text for the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols ("cap-and-trade"). LS Power is engaged in the development, acquisition and management of power generation and transmission infrastructure. In addition to its natural gas-fired facilities, LS Power is currently investing in wind and solar resources.

LS Power, as an importer of power into the CA markets, seeks, as do other market participants, regulatory certainty around the newly developing cap-and-trade market and to have the regulations promulgated by this agency withstand the legal challenges that are sure to arise on a myriad of issues. LS Power's primary concern with the most recent regulatory package is that CARB continues to rely on e-tags to designate ownership of imported power and has removed language which utilized the title holder of power as the power crosses the political border of California as the point of regulation over imported power. Title is the concept that makes the assertion of CARB's jurisdiction over imports much clearer from a legal and commercial perspective. In the current version, the cap-and-trade program does not adequately contemplate the interstate nature of the western electricity system or the legal bounds of CARB's jurisdiction. For the reasons explained below, the cap-and-trade program, with respect to its treatment of electric transactions occurring at locations outside of California, violates the Commerce Clause of the U.S. Constitution which limits the ability of a state to regulate commercial activities occurring outside its borders.

To provide a means of correcting this deficiency, LS Power requests that CARB, in its resolution approving the cap-and-trade program, include a direction to staff which identifies the electricity importer definition as a specific topic that will be addressed in a subsequent rulemaking before the cap-and-trade program takes effect.

Notwithstanding these concerns, LS Power expresses its support for the changes to the Resource Shuffling provisions and staff's recognition that further clarification is needed for those provisions. LS Power requests that staff continue to evaluate the appropriateness of the default emissions factor set forth in the Mandatory Reporting Regulation, striving for consistency with the emissions determinations of other regulatory agencies and establish emissions factor that is the most reflective of imports into California. Additionally, LS Power asks CARB take care to avoid limiting the flexibility provided for in the new RPS law which allows firming and shaping of renewable energy throughout the multi-year compliance periods.

1. **The September 12, 2011 Revisions to the Cap-and-trade Regulation Expose the Program to Litigation Risk by Violating the Commerce Clause of the United States Constitution.**

The stated intent of the cap-and-trade program, as it applies to the electricity sector, is to impose a compliance obligation on in-state power plants and imports into this state from out-of-state power plants. At the highest level, these points of regulation appear simple. But in its application to the interstate electric marketplace, the regulation seeks to impose CARB's jurisdiction over activities that are exceedingly complex. The wholesale electricity markets are operated in real time, across state and international borders. In California, there are several balancing authority areas, some of which extend beyond the state's borders. In other words, the western electricity system is a quintessential example of "interstate commerce", and as CARB seeks to regulate the California portion of this system, CARB must carefully evaluate the legal scope of its jurisdictional reach. The most recent changes to the regulation obscure the line between regulating in-state activities and those which occur entirely out-of-state. If these issues are not remedied, LS Power is concerned that the regulation is susceptible to legal challenge on the basis of the Commerce Clause.

The September 12, 2011 version of the regulation includes three substantial revisions to the definition for Electricity Importer (Proposed 17 Cal. Code Reg. § 95802(a)(87)). First, the following sentence has been deleted: "when PSEs are not subject to the regulatory authority of ARB, including tribal nations, the electricity importer is the immediate downstream purchaser or recipient that is subject to the regulatory authority of ARB." This sentence helped clarify that when CARB does not have jurisdiction over an import because the delivery occurred out-of-state, CARB's jurisdiction will apply to the entity that it can regulate: the purchaser bringing the power into the state. Second, the electricity importer definition no longer refers to the entity holding title to the power, and instead relies solely on the purchasing-selling entity (PSE) identified on the NERC e-tag. As noted in LS Power's August 11th Comment letter on the previous version of the regulation, e-tags do not accurately track ownership of power, and are an imprecise and inappropriate tool for determining the reach of CARB's jurisdiction.[1] Third, the electricity importer definition includes new language stating that the operator of an out-of-state facility is an importer when the first point of interconnection is to a "California Balancing Authority." As noted above, a California Balancing Authority can have territorial areas located outside of California and an operator of such an out-of-state facility may not hold title to power when it comes across the border into California. Collectively, these changes will lead to circumstances where CARB's jurisdictional reach seeks to regulate a seller of electricity even though the seller never owns power as the power is transmitted across California's borders.

States cannot regulate commercial activities occurring wholly outside their borders, and doing so constitutes a violation of the Commerce Clause. Article 1, Section 8, Clause 3 of the United States Constitution provides that "The Congress shall have power to regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes." The importance of the Commerce Clause extends beyond simply describing the power of Congress. The Commerce Clause has been interpreted by courts to implicitly govern the power of states. For example, in *New York Life Insurance Co. v. Head*, 234 U.S. 149 (1914), the U.S. Supreme Court determined that "it would be impossible to permit the statutes of Missouri to operate beyond the jurisdiction of that State . . . without throwing down the constitutional barriers by which all the States are restricted within the orbits of their lawful authority and upon the preservation of which the Government under the Constitution depends."

More recently, in *Edgar v. Mite Corp.*, the U.S. Supreme Court interpreted the Commerce Clause to "preclude the application of a state statute to commerce that takes place wholly outside of the State's borders, *whether or not the commerce has effects within the State*." (See, *Edgar v. Mite Corp.* 457 U.S. 624, 642, (1982), emphasis added.) This language was quoted by the Court in *Healy v. the Beer Institute*, 491 U.S. 324 (1989), when the Court struck down a Connecticut statute requiring out-of-state shippers to affirm that the prices charged to wholesalers in Connecticut were no greater than prices charged in neighboring states. In *Healy*, the Court concluded that the Connecticut statute had the "undeniable effect of controlling commercial activity occurring wholly outside the boundary of the State." (*Healy* v. *The Beer Institute*, at p. 337). Importantly, in both of these cases, the underlying activities that started the lawsuits had impacts on the states. Even though the commerce had effects within the state, the commerce occurred wholly outside the state's borders. Similarly, in the context of an electricity import, when title to the power is transferred to a purchaser at a point physically located out-of-state, the commercial activity occurs wholly outside the State of California. Even

1 See LS Power Comments on July 25, 2011 version of the Proposed Cap-and-trade Regulation, available at: http://www.arb.ca.gov/lists/capandtrade10/1490-110811_ls_power_comments_on_cap-and-trade_15-day_language__00017239_.pdf

though the power eventually comes into California, CARB's jurisdiction cannot extend to the sellers in these instances without offending the Commerce Clause. Moreover, CARB's California program, and the manner it would attach to importers and operators of certain generators located outside the state, will undoubtedly influence the prices for interstate transactions occurring at market hubs located outside California.

Thus, in the current form, the cap-and-trade regulation creates a significant risk that the program could be challenged because it violates the Commerce Clause. Such litigation risk creates uncertainty for the program and undermines confidence in the cap-and-trade markets, which is especially needed in the incipient stages of the program. Moreover, out-of-state sellers participating in CAISO markets by delivering to out-of-state nodes, such as LS Power, who may choose not to challenge the regulations, will be at a competitive disadvantage compared to out-of-state sellers that may not choose to submit to CARB's jurisdiction. In sum, the invalid extension of CARB's jurisdiction through the importer definitions is a significant deficiency in the cap-and-trade program that needs to be remedied before the program starts. Accordingly, LS Power requests that CARB specifically acknowledge these deficiencies through a Board Resolution if and when the cap-and-trade program is adopted and approved at the October Board hearing. The board resolution should specifically direct staff to address these concerns in a subsequent rulemaking before the start of the program (i.e. early 2012).

2. LS Power Supports the Changes to the Resource Shuffling Provisions, Provided that there Will Be Further Clarification Before The Program Starts.

The Resource Shuffling provisions (Propose 17 Cal. Code Reg. §§ 95802(a)(251), and 95852(b)(2)) have been modified to remove two specific activities from Resource Shuffling. LS Power supports the general goal of discouraging importers from misrepresenting their GHG emissions. However, parties, including LS Power, expressed significant concerns in comments on the July 25, 2011 version of the Resource Shuffling provisions because it was unclear when an otherwise legitimate and commercially-rational transaction could become illegitimate because it fell within the vague definition. The most recent changes on this topic are an improvement, but the remaining language stating that "'Resource Shuffling' means any plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid" still lacks clarity. LS Power therefore requests that the Board specifically address this as an area that will be subject to further revision before the start of the cap-and-trade program. In addition, staff should continue to consider LS Power's previous suggestion to include additional changes to the regulations that would allow for an upfront determination that a specified importer is not engaged in resource shuffling where CARB has issued a specified emissions factor for a particular facility that is applied to output sold into the CAISO or other California markets.

3. CARB Should Amend the Default Emissions Factor to be More Representative of Generation within the WECC and Consistent with the CEC's Emissions Performance Standard.

Section 95111(b)(1) of the MRR sets the default emissions factor at 0.428 Metric Tons of CO2e/MWh. As noted in LS Power's comments on the July 25, 2011 version of the regulation, LS Power believes that the current default emissions rate is set too low and will compromise CARB's GHG emissions goals. An emissions factor of 0.428 creates an incentive for any out-of-state power plant with an efficiency factor higher than 0.428 to enter into a transaction with a marketer so that it can report its emissions as unspecified. Consequently, the actual GHG emissions attributable to the state will be higher than what is reported and satisfied through the cap-and-trade compliance obligation of unspecified importers. Moreover, in-state generation will be disadvantaged in the market because the emissions rate against which their compliance obligation is determined will be higher than the imputed value of unspecified emissions applied to out-of-state resources that will carry a lower compliance obligation. LS Power requests that CARB continue to evaluate the default emissions factor, striving for greater consistency with the CEC's Emissions Performance Standard and a number that is more representative of generation within the WECC. Specifically, CARB should adopt a capacity-weighted average, which will result in a default emissions factor that is much closer to the EPS. LS Power also requests that CARB consider the more detailed comments on this issue that were submitted on September 27, 2011 in its response to the September 12, 2011 version of the Mandatory Reporting Regulation.

4. CARB Should Avoid Imposing Regulations That Conflict With the RPS Program.

LS Power is concerned that CARB's proposed rules regarding the treatment of power used to firm and shape RPS deliveries, particularly power used to deliver renewable energy credits (RECs) into California at a time later than the production from the renewable resource, will conflict with provisions found in the new 33% RPS law. Specifically, new Public Utilities Code Section 399.16(a)(6) provides a 36 month "shelf life" for RECs. Provisions in the CARB regulations would hinder the flexibility provided by the Legislature by imposing a current year delivery requirement to avoid a compliance obligation for power imported to deliver the REC (the RPS Adjustment mechanism). This should be avoided. The implementation details for the RPS program are still under development at the CPUC and the CEC. It is critical for the developers, marketers and purchasers of RPS products, particularly those contemplating firmed and shaped transactions, to not lose the additional flexibility for delivery and multi-year compliance periods provided in the new 33% RPS law.

In conclusion, LS Power requests that in a board resolution, CARB identify the electricity importer definition as a specific topic that will be addressed in a subsequent rulemaking before the cap-and-trade program takes effect. LS Power also requests that the Board note the lack of clarity in the Resource Shuffling provisions and direct Staff to revise those provisions with further stakeholder input. LS Power requests that the Board amend the default emissions factor to be more consistent with the emissions factors adopted by other regulatory agencies and a better representation of generation within the WECC. Finally, provisions impacting the use of RECs under the RPS program must be revised to avoid truncating the flexibility provided for in the new RPS law. LS Power appreciates the opportunity to provide these comments, and looks forward to continuing its efforts with staff on these matters.

Sincerely,

Jennifer Chamberlin
LS Power