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Electronically Submitted

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Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: Comments of the **Northern California Power Agency** on the *Second 15-Day Revisions for the Proposed Regulation to Implement the California Cap-and-Trade Program*

Dear Sir:

The Northern California Power Agency[1] (NCPA) provides these comments on the *Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information* (Second 15-day Revisions or Proposed Revisions) for the *Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols* (Proposed Regulation) released by the California Air Resources Board (CARB) on September 12, 2011.

As noted in NCPA's comments on the first set of revisions to the Proposed Regulation,2 NCPA and its member agencies are committed to achieving the goals and objectives of California's greenhouse gas (GHG) emissions reduction measures, and have been active participants before the CARB regarding many of the programs considered and adopted pursuant to the Scoping Plan. In furtherance of that collaborative effort and to facilitate the ongoing development of the Cap-and-Trade Program (Program) in a manner that will allow the State to

1 NCPA is a not-for-profit Joint Powers Agency, whose members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, and the Truckee Donner Public Utility District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

2 *Comments of the Northern California Power Agency on the 15-Day Revisions for the Proposed Regulation to Implement the California Cap-and-Trade Program*, dated August 11, 2011 (August 11 Comments).

meet its emissions reduction goals while ensuring that electrical distribution utilities are able to continue to provide safe, reliable, and reasonably priced electricity to California residents and businesses, NCPA offers these comments.

In its August 11 Comments, NCPA raised significant concerns regarding several of the suggested revisions to the Proposed Regulation that were made available for the first time in the July 27 Modified Text. The Second 15-day Revisions reflect significant and much needed revisions to that language, clearly moving the Proposed Regulation in the right direction. NCPA appreciates Staff's contemplation of the comments received from stakeholders on these crucial issues – specifically those issues that impact the operations of both the allowance market and the statewide and regional electricity markets.

I. COMMENTS ON THE MODIFIED TEXT

§ 95852(b)(1) Calculation for Compliance Obligation

NCPA supports the revisions to § 95852(b)(1) that adds the entire calculation for determining a compliance obligation of first deliverers in the Regulation, rather than references to the Mandatory Reporting Regulation (MRR). Including the relevant information and calculation within the Cap-and-Trade Program Regulation avoids confusion and the potential for miscalculations by removing the need to continually cross-reference the two regulations.

§ 95852(b)(4) RPS Adjustment

The Second 15-day Revisions would eliminate in their entirety the previous definition for "replacement electricity" and "variable resources." Instead, the Regulation now includes a definition under the first deliverer's compliance obligation that addresses an RPS adjustment. NCPA supports the proposed changes that would not unduly and needlessly impose emissions obligations on electricity that is delivered to California as part of a renewable portfolio standard (RPS) contract. NCPA appreciates the recognition that the Cap-and-Trade Program's treatment of renewable resources will directly impact compliance entities' ability to meet the obligation of both the Cap-and-Trade program and the State's increasing renewable energy mandates, and

supports the compliance obligation calculation in § 95852(b)(1)(B) that now includes a provision to address RPS eligible contracts. As previously proposed, the treatment of replacement electricity would have severely hindered the ability of compliance entities to meet these dual objectives. The inclusion of the RPS adjustment goes far towards reconciling these commitments. This change recognizes the significant investments electrical distribution utilities and other compliance entities have already made in renewable resources and an understanding of the manner in which these contracts utilize the renewable power and reduce overall emissions. This Proposed Revision properly allows an adjustment for imported electricity associated with renewable contracts that are used to meet the State's PRS mandate to be deducted from the total compliance obligation.

CARB should utilize the Proposed Revision as the basis for reviewing the emissions obligations associated with renewable energy contracts, rather than the more onerous "replacement electricity" provisions found in the July 27 Modified Text that would have placed restrictions on the calculation of the compliance obligation based balancing authority boundaries that had no relationship to the actual production or delivery of the renewable resource. NCPA cautions, however, that the language should not place restrictions on ownership types, in order to ensure that none of the various interests in these renewable resources are precluded from utilizing the RPS adjustment. Likewise, this is the case with regard to the "contracts" to import electricity for the compliance entity set forth in § 95852(b)(4)(A)(2), the arrangements for delivery of the electricity may take different forms, and there should not be strict adherence to the term "contract," as long as a legitimate arrangement exists between the parties.

While NCPA supports the inclusion of the RPS adjustment, the current proposal to automatically sunset the use of the RPS adjustment upon linking (set forth in § 95852(b)(4)(E)) should be removed. While the Cap-and-Trade Program will undoubtedly benefit from an increased number of trading partners, it is going to be necessary for CARB and stakeholders to carefully examine aspects of the California program that will be impacted by linking. Accordingly, the appropriate time to review and analyze how the RPS adjustment should be addressed when linking with a partner jurisdiction is during that rulemaking process, and until

that process is complete, there should be no cloud cast over how a compliance entity's RPS adjustment will be calculated in any given year. Treatment of the RPS adjustment should be included in the list of issues reviewed in the process of the subarticle 12 rulemaking specifically addressing linking, and accordingly, § 95852(b)(4)(E) should be stricken in its entirety at this time.

§ 95802(a)(245) and § 95852(b)(1) Prohibitions on Resource Shuffling

The Revisions regarding resource shuffling set forth in § 95802(a)(245) and § 95852(b)(1) clearly move in the right direction. These changes acknowledge the concerns raised by NCPA and other stakeholders that legitimate market operations and transactions can be inappropriately caught up in the wide net that was cast by the definition proposed in the first proposed 15-day revisions. NPCA understand that CARB intends to continue to review this matter and attempt to define the prohibited transaction as part of a new Rulemaking that will address revisions to the Rulemaking. In doing so, NCPA urges staff to work closely with the electricity sector stakeholders. It is imperative to the success of the Cap-and-Trade Program and the efficient and cost-effective operation of the electricity grid throughout the Western Electricity Coordinating Council that this definition be carefully crafted. The final definition adopted by CARB has the potential to adversely impact electric utilities and should be carefully crafted to ensure that the result is not a prohibition on standard and existing electric transactions that maximize the efficient use of the State's electric transmission system and economic dispatch of electric generation resources. Rather, resource shuffling should be narrowly defined in order to avoid adverse and inadvertent impacts on typical electricity market activity, but broad enough to ensure that true malfeasance is prohibited. NCPA looks forward to continuing to work with CARB Staff on this crucial issue.

NCPA also supports CARB's removal of the reference to fraud, and the Proposed Revisions to the attestation requirements that properly acknowledge that the affirmation is done by the individual in his or her official capacity as an employee of the compliance entity, rather than personally.

§ 95852(c) Natural Gas Suppliers and Deliveries to Covered Entities

Provisions in § 95852(c) of the Second 15-day Revisions recognize that natural gas suppliers' compliance obligation will be reduced by the amount of natural gas supplied to an entity that already has a compliance obligation under the Cap-and-Trade Program, and properly includes that metric in the calculation of their overall obligation. However, despite this acknowledgement, there is still a disconnect between this reduced compliance obligation for the natural gas supplier and the ability to track the fuel sold to compliance entities in forward markets. Because forward contracts for natural gas are transacted on electronic exchanges, there is no way to identify sales to covered entities in advance of completing the transaction. Accordingly, it is likely that natural gas suppliers will incorporate the cost of the GHG compliance obligation into the price of the natural gas contracts, since CARB computes the compliance obligation after the fact, rather than at the time of the sale. Because futures markets are going on even at this time – for fuel that will be sold during the second compliance period – there is a need to address this issue now, and not wait until the second compliance period.

Without some direct means to track the contracts between buyers and sellers *before* the price of the gas is set, buyers of natural gas with a compliance obligation under the Cap-and-Trade Program will still face the prospect of paying twice for emissions associated with that gas. This is because the seller will not know at the time that the contract is entered into whether or not the buyer is a covered entity. Therefore, since the seller's compliance obligation will not be know at the time of the sale, they will need to include the potential compliance cost in the price of natural gas sold.

In order to address this, NCPA recommends that CARB provide allowances to these covered entities in an amount equal to the amount of CO_2e of GHG emissions for natural gas delivered to covered entities to offset the emissions associated with the compliance obligation that will be borne by the covered entities for the delivered natural gas. This adjustment does not create any additional allowances, as the compliance obligation associated with the supply of natural gas will have increased by an equal amount to the covered entity's free allocation. This is the most efficient means by which to eliminate the potential for double charging the buyer

(covered entity) for the carbon cost. NCPA urges CARB to address this issue now, and not wait until 2014.

§ 95833 Direct and Indirect Corporate Associations

NCPA supports the Proposed Revisions to § 95833 that increases the threshold for determining a "direct corporate association" from 20% to 50%, as well as the intent of the provision to "apply only in instances where one entity has clear control over another."

§ 95857 Untimely Surrender of Compliance Instruments

NCPA supports the Proposed Revision to § 95857(b)(4) that would allow compliance entities to meet one-quarter of their untimely surrender obligation with offsets, rather than requiring only allowances to be surrendered. In § 95857(b)(6), NCPA continues to urge CARB to allow at least two weeks (or 10 business days) between the first auction or reserve auction following the surrender date and the deadline for surrendering the untimely obligation.

§ 95858 (c) and (d) Compliance Obligations for Underreporting

The Second 15-day Revisions clarify that the compliance obligation associated with underreporting in a previous period (found in § 95858) are not subject to the untimely surrender obligation (§ 95857) or direct penalty provisions (§ 96014) if the obligation is met within six months. The Proposed Revisions would also place an eight year limit on the look-back period for underreporting. NCPA supports these proposed changes for inclusion in the Cap-and-Trade Regulation and urges CARB to adopt them.

§ 95892 and Table 9-3, Allocation to Electrical Distribution Utilities

Allocation to Electrical Distribution Utilities § 95892(a): The Proposed Revisions update and correct the allowance allocations to electrical distribution utilities set forth in Table 9-3 for that each electrical distribution utility is to receive from 2013 to 2020. (§95892(a)) NCPA supports these revisions, and the clarification that distinguishes between electrical cooperatives

(COOPs) and POUs.

Designation into POU Accounts § 95892(b)(2): NCPA supports the further revisions and clarifications to § 95892(b)(2) regarding the manner in which the allocated allowances are placed into the electrical distribution utilities' various accounts. For POU electrical distribution utilities, the Executive Director will place the allowances into the limited use holding account or into a compliance account "per the entity's preference. For further clarification, NCPA proposes that § 95892(b)(2)(A) be slightly revised to ensure that the language clearly clarifies the intent to provide three separate options for the compliance accounts into which allowances can be designated:

> *"in the compliance account of an electrical generating facility operated by a publicly owned electric utility, or the compliance account of an electrical cooperative, or the compliance account of a Joint Powers Agency in which the electrical distribution utility or electric cooperative is a member and which it has a power purchase agreement."*

Prohibitions on Use of Value § 95892(d)(5): The Proposed Regulation includes specific limitations on the use of both auction revenues and allowance value in § 95892(a) and (d)(3), as well as requirements to annually report to the Executive Officer regarding the use of those allowances and value. These provisions are applicable to all electrical distribution utilities. However, the Proposed Revisions also include a prohibition that singles out compliance entities that are located within the California Independent System Operator (CAISO) for disparate treatment and has the potential to hinder wholesale electric transactions. Section 95892(d)(5) prohibits the use of allowance value "to meet compliance obligations for electricity sold into the California Independent System Operator markets." This provision should be stricken, as it fails to recognize the manner in which energy transactions through the CAISO Balancing Authority work. For example, entities such as NCPA, who have transactions that must be scheduled through the CAISO Balancing Authority, including self scheduled energy that is delivered directly to load, this prohibition would place an unreasonable constraint on utility operations. Due to the CAISO's rules for scheduling and bidding, tracking the various permutations of such transactions would be virtually impossible. Further, POUs located in the CAISO Balancing Authority must sell all of their self-owned generation into the CAISO markets, and then purchase

the electricity back, even if it is for the exact same quantity of electricity. The provisions of § 95892(d)(5) would preclude these entities from being able to use allowance value to meet their compliance obligations associated with the production of this electricity. This provision places an undue and unwarranted restriction on entities that are mandated to participate in the ISO markets, with no resulting benefit to the underlying intent of the Proposed Regulation to ensure that allowance value is used "for the benefit of retail ratepayers consistent with the goals of AB 32." Accordingly, NCPA urges CARB to strike § 95892(d)(5) it in its entirety.

§ 95913 Allowance Price Containment Reserve Account

NCPA fully supports the Reserve Account established in § 95831(b)(4), but continues to be concerned that the Proposed Revisions to this section do not include a mechanism to ensure the availability of allowances in the Reserve Account. Since this account is created as a means by which to ensure that allowances prices are contained in the market, it is imperative that there be an ample supply of allowances in the Reserve Account for compliance entities to purchase in the event that the market is not stable. NCPA joins with other stakeholders in urging CARB to ensure that there is mechanism in place to guarantee a minimum number of allowances in the Reserve Account throughout the duration of the Cap-and-Trade Program.

§ 96014 Violations

In § 96014, the Second 15-Day Revisions properly recognize that "daily" penalties are excessive, and that separate violations should accrue every 45-days for compliance instruments that remain unsurrendered, rather than on a daily basis. NCPA urges CARB to further address the issue of potentially excessive penalties and, when looking at violations under this section, consider each 1,000 compliance instruments (or portion thereof) as a single violation, rather than one compliance instrument. Given the order of magnitude of allowances in the Cap-and-Trade Program, violations based on each 1,000 instruments is a viable option that still holds compliance entities accountable, without being excessive.

II. NEXT STEPS MOVING FORWARD

The ongoing monitoring and reviewing of the allowance market, and particularly the auctions and availability of allowances in the Reserve Account, are crucial elements needed for the success of the entire program. Indeed, no matter how well planned in advance, unless there are procedures in place to closely monitor ongoing activities, and mechanisms to address and correct problems as they are discovered, the success of the entire Cap-and-Trade Program will be jeopardized.

NCPA urges CARB to pay close attention to the start-up procedures and market simulations, and to include provisions in the Regulation – or at a minimum in a Resolution approving the revisions to the Cap-and-Trade Program – that will allow the agency to delay the initial auction if problems are discovered that cannot be timely corrected. While NCPA understands CARB's eagerness to move forward with the program and begin auctions for allowances in the second half of 2012, doing so without a full analysis of potential problems will have more adverse ramifications that delaying the auctions at the onset of the program.

III. CONCLUSION

NCPA appreciates the opportunity to provide these comments on the *Second 15-Day Revisions* of the *Proposed Regulation to Implement a California Cap-and-Trade Program*. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or scott.tomashefsky@ncpa.com.

Sincerely,
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