Comments of the Western Power Trading Forum
On the California Air Resources Board's
Modified Regulation Order
For a California Cap and Trade Program

September 27, 2011

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I. Introduction and Overview

The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide comments to the California Air Resources Board (CARB) on its 2nd 15-day modifications to the Regulation Order for a California Greenhouse Gas Cap and Trade Program (MRO), issued on September 12, 2011. WPTF has consistently supported establishment of a cap and trade program to achieve emission reductions under Assembly Bill 32 (AB32), and has worked cooperatively with CARB staff over the past few years to ensure that the program is fair and effective. However, WPTF remains concerned with several provisions in the Regulation that have the potential to unnecessarily raise costs or impair the ability of obligated entities to comply with the cap and trade program and the state's Renewable Portfolio Standard (RPS):

- Despite the guidance provided in the December Board Resolution approving the cap and trade program, the MRO does not adequately address the issues associated with carbon cost recovery by independent power producers operating under long-term contracts that pre-date AB32 and do not provide for pass through of those costs.
- The MRO's limits on holding of compliance instruments and auction purchases discriminates against entities with large compliance obligations and would impair their ability to effectively manage their compliance requirements.
- The definition of resource-shuffling is overly broad and could inhibit legitimate imports of clean energy.
- Requirements for claims of specified renewable imports and the RPS Adjustment conflict with the multi-year compliance framework of the RPS law.
- The approach to netting of 'qualified exports' against an entity's imports within the same hour will significantly overstate California electricity consumption, thereby arbitrarily and unnecessarily raising allowance prices and overall electricity prices, and making the cap and trade regulation more vulnerable to legal challenges from electricity importers.

Due to the truncated rule-making process this year, WPTF believes that these issues have not been adequately considered and addressed by CARB. In our more detailed comments below, we explain why the Board must take action to ensure that CARB staff may continue to make modifications to address these important issues.

WPTF understands the Board's desire to adopt an MRO so that implementation of the cap and trade program can proceed in 2012, and the concern that an acknowledgement that further refinements to the MRO are necessary may stand in the way of such implementation. WPTF does not believe that action by the Board to preserve the ability for Staff to continue vetting these important issues with market participants, and to bring modifications to the Board as necessary, will serve in any way to conflict with adoption of the MRO in October. In fact, WPTF would support adoption of the cap and trade program in October, provided that CARB work to improve

[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within California, western states, as well as other markets across the United States.

the MRO through stakeholder workshops and rule-making in 2012. We therefore urge that the following language be include in the Board Resolution adopting the cap and trade program:

"*The Board directs the Executive Officer of the Air Resource Board to initiate Rulemaking to be completed by June 2012 to address the following outstanding issues in the cap and the trade program:*

1) *Establishment of a process to identify and provide for carbon-cost recovery to independent power producers operating under long-term contracts that do not provide for pass through of costs associated with compliance with the cap and trade program on a case by case basis;*
2) *Review of the auction purchase and holding limits to ensure that they are equitable to all covered entities and do not impair the ability of entities to manage costs of compliance with the program;*
3) *Review and modify the requirements for electricity imports, including:*
    a. *Elaboration of the definition of 'resource-shuffling' and requirements for specified imports to ensure consistency with AB32 goals, to provide clarity to importers and verifiers on how to identify (and thus avoid) resource-shuffling, and to permit legitimate claims to specified imports;*
    b. *Evaluation, and modification, of the requirements for renewable imports and the RPS Adjustment to ensure they are consistent with the statutory RPS framework and implementing regulations developed by the California Public Utilites Commission ("CPUC") and California Energy Commission ("CEC").*
    c. *Revision of the requirements for "qualified exports" and associated emissions subject to the cap and trade program to ensure that compliance emissions for the electricity sector accurately reflect California consumption of electricity;*

The Board further directs the Executive Officer to contract with an independent entity with appropriate expertise in wholesale electricity markets to assist staff in addressing the complexities associated with implementing these regulations for electricity imports."

We provide more detailed comments on our concerns and proposed changes to the MRO to address some of these concerns below.

II. General Comments

1. *The MRO must include a mechanism to adequately address the issues associated with carbon-cost recovery to independent generators operating under long-term contracts that do not provide for pass through of the compliance costs.*

The CARB Staff proposal for modification to the original proposed regulatory order[2], submitted to and approved by the Air Resources Board on December 16, stated that "Staff will work with interested stakeholders *to ensure proper treatment under the regulation* of any electricity generators or combined heat and power facilities with pre- AB 32 long-term contracts that do not allow for pass-through of costs associated with greenhouse gas emissions." WPTF members, as well as other affected power producers have had numerous interactions with CARB staff on this

[2] http://www.arb.ca.gov/regact/2010/capandtrade10/res1042attB.pdf

issue over the past year. WPTF understands CARB's desire that such issues should be address by the contractual counterparties, and it is WPTF understanding that attempts to do so remain ongoing. Nevertheless, the fact remains that there is little incentive for a contractual solution when the parties to the transaction are not approaching the negotiations on a level playing field; the current MRO disadvantages one counterparty over the other, ultimately discouraging contract renegotiation. WPTF has provided CARB staff with proposed language to address these issues. Despite these efforts, the MRO still provides no mechanism to ensure that affected power producers can recover their carbon cost, even though other capped entities that cannot recover carbon costs receive direct assistance in the form of direct allowance allocation.

WPTF has previously provided recommendations on criteria for evaluating the situation of power producers under long-term contracts and a process for ensuring cost recovery through allowance allocation. We urge CARB to establish a process to:

- Define the conditions under which an independent power producer would be eligible for cost-recovery assistance (e.g., contracts entered into after adoption of AB 32 would not be eligible for relief);
- Identify documentation to be provided by the producer to demonstrate that it meets these conditions;
- Facilitate renegotiation of contracts in cases where the counter-party receives a direct allocation of allowances under the cap and trade program; and/or
- Provide for direct allocation of allowances to independent power producers to cover emissions associated with these contracts in cases where the contract cannot be renegotiated.

2. The holding limits and auctions purchase limits should be changed so as not to disadvantage covered entities with large compliance obligations.

WPTF has previously raised a concern that the holding limit will disadvantage capped entities with large compliance obligations. Because the holding limit is set at the same level for all entities, regardless of the scale of each entity's compliance obligation, some entities would be able to purchase and hold a quantity of allowances significantly higher than their compliance obligation while other entities would not even be able to hold sufficient allowances to cover their obligation in a single year. The holding limit thus discriminates among capped entities, and will hinder the ability of some entities to effectively manage their compliance with the cap and trade program, to the likely benefit of those entities who are not subject to the same restrictions.

WPTF recommends that CARB review and modify the auction purchase and holding limits to ensure that they are equitable to all capped entities and do not impair their ability to comply with the program.

3. More clarity is needed on resource-shuffling and requirements for specification of imports.

In comments on the first 15 day package, WPTF and other stakeholders raised serious concerns that provisions in that package related to 'resource-shuffling' could result in electricity importers being subject to financial penalties and potentially criminal consequences for events that are outside that entity's control. In response to these concerns, CARB staff has modified the

definition of resource-shuffling to eliminate specific elements that were considered particularly problematic. We appreciate CARB's efforts to address stakeholder concerns, but unfortunately, the revised language is now so broadly defined that it provides no clarity or regulatory certainty regarding which transactions would be considered legitimate specified or non-specified imports and which would be considered resource-shuffling.

To remedy these shortcomings, WPTF strongly urges CARB to further develop the provisions related to resource-shuffling and specification of imported electricity through a formal stakeholder process next year. The goal of this process should be to develop a clearer definition of resource shuffling and requirements for specified imports that are consistent with goals of AB32 and normal electricity market practices. WPTF also recommends the development of guidance documents that could be used by importers and verifiers to determine whether imports can or must be claimed as specified. Such guidance documents should provide examples of normal and anticipated import scenarios.

4. Provisions related to renewable imports must be modified for consistency with the RPS.

The MRO provides 2 scenarios under which an importer may claim a clean emission rate for imported power: (i) direct delivery from a renewable generator and (ii) through the RPS adjustment for renewable procurement that is firmed and shaped. In both cases, the regulation requires that the Renewable Energy Credits (RECs) associated with the renewable energy generation be retired/used[3] for compliance with the RPS. This requirement would mean that an entity that wishes to claim either direct delivery or the RPS adjustment for renewable procurement would have to retire the associated REC in the same calendar year in which the REC was generated. Further, because the language pertaining to the RPS adjustment states the REC "must be used to comply", it suggests that the RECs that are retired and banked by a California retail provider for later compliance use cannot be used for an RPS adjustment. Both results are inconsistent with the RPS compliance flexibility provided under California's RPS law.

SB X1-2 allows RECs to be traded for 3 years after generation. After 3 years the RECs must be retired. Further, importers under the cap and trade program may be generators, marketers or load-serving entity. Generators and marketers of imported renewable energy may not be able to avail themselves of the cleaner emission rate because they are not the end-user of the RECs and cannot compel retirement.

While many of the details of implementation of SB X1-2 remain to be determined through CPUC and CEC proceedings, it would be inappropriate for CARB to prejudge the outcome or to adopt regulations in the cap and trade program that conflict with the RPS program, and therefore the MRO should clearly specify that the CARB regulations are not intended to conflict with the RPS compliance requirements or to reduce the compliance flexibility afforded in the RPS statute.

Per conversations with CARB staff, we understand that the requirement for REC retirement was added to the regulation to address two objectives: that renewable imports not be claimed for both an allowance retirement under the cap and trade program's Voluntary Renewable Energy set-

[3] For directly delivered renewable energy, the regulation requires that "If RECs were created for the electricity generated and reported pursuant to MRR, then the RECS must be retired and verified pursuant to MRR." For the RPS adjustment, the regulation requires that "The RECs associated with the electricity claimed for the RPS adjustment must be used to comply with the California RPS requirements during the same year in which the RPS adjustment is claimed."

aside and that there is a clear nexus between any claims to renewable energy imports under the cap and trade program and the RPS program. WPTF does not object to these goals, but believes they could be accomplished in a way that does not conflict with RPS Law nor restrict flexibility under the RPS program. Specifically, we recommend that the regulation be modified to make claims to imported renewable energy or the RPS adjustment contingent upon *procurement* of RECs, rather than reporting the REC's for compliance. CARB can avoid potential double-counting with the VRE program simply be prohibiting the same energy from being claimed for both the RPS adjustment and the VRE program. This would be easily verified by requiring reporting of REC serial numbers under both the VRE and the RPS adjustment.

We therefore suggest that following changes to section §95852 of the regulation:

(3) The following criteria must be met for electricity deliveries to calculate their compliance obligations based on an ARB facility specific emission factor specified pursuant to MRR section 95111 less than the default emission factor for unspecified electricity specified pursuant to MRR section 95111:
(A) Electricity deliveries must be reported to ARB and emissions must be calculate pursuant to MRR section 95111;
(B) The electricity importer must be the facility operator or have ownership or a written power contract, as defined in MRR section 95102(a) to the amount of electricity claimed and generated by the facility or unit claimed;
(C) The electricity must be directly delivered, as defined in MRR section 95102(a), to the California grid, and
(D) ~~If RECs were created for the electricity generated and reported pursuant to MRR, then the RECs must be retired and verified pursuant to MRR.~~ If the electricity claimed is from an eligible renewable energy resource, the electricity importer must have ownership or contract rights to procure RECs associated with the claimed electricity or a contract to import the electricity on behalf of a California entity that has ownership or contract rights to procure RECS associated with the claimed energy.

(4) RPS Adjustment. Electricity imported ~~or procured~~ by an electricity importer from an eligible renewable energy resource reported pursuant to MRR must meet the following conditions to be included in the calculation of the RPS adjustment:

(A)The electricity importer must have either:
(1) Ownership or contract rights to procure RECs associated with the electricity generated by the eligible renewable resource or
(2) Have a contract to import electricity on behalf of a California entity that has ownership or contract rights to procure RECs associated with the electricity generated by the eligible renewable energy resource, ~~as verified under MRR~~.

~~(B) The RECs associated with t~~The electricity claimed for the RPS adjustment must be imported ~~used to comply with California RPS requirements~~ during the same calendar year in which the RECs procured from the eligible renewable energy resource are generated; ~~RPS adjustment is claimed.~~

(C) The quantity of emissions included in the RPS adjustment is calculated as the product of the default emission factor for unspecified sources, pursuant to MRR, and the reported electricity generated (MWh) that meets the requirements of this section, 95852(b)(4).
(D) No RPS adjustment may be claimed for an eligible renewable energy resource when its electricity is directly delivered or claimed as Voluntary Renewable Energy.
(E) No RPS adjustment may be claimed for electricity generated by an eligible renewable energy resource in a jurisdiction where a GHG emissions trading system has been approved for linkage by the Board pursuant to subarticle 12.

5. Provisions for qualified exports

Assembly Bill 32 directs the California Air Resources Board (CARB) to account for emissions associated with all electricity consumed in the state. WPTF has previously raised concerns that the approach taken by CARB, which imputes emission liability for imports on the basis of gross electricity imports, would significantly overstate electricity consumption in the state, arbitrarily and unnecessarily raise allowance and ultimately electricity prices, and make the cap and trade regulation more vulnerable to legal challenges from electricity importers.

The MRO has partially addressed this concern through inclusion of a "Qualified Export (QE) Adjustment" in section 95852. Under the QE Adjustment individual entities may net exported electricity against imported electricity within same hour. However, because the QE Adjustment does not provide for netting across individual entities, it would still overestimate statewide electricity consumption due to residual exports that are not accounted.

Absent a mechanism to account for these residual exports within the cap and trade program, the market will create opportunities for electric power entities to coordinate their import and export transactions into wheel-through transactions. While this behavior would better reflect electricity consumed in the state, it would increase transaction costs for importers and place additional burden on the California Independent System Operator (CAISO). We therefore recommend that CARB work with electricity sector stakeholders, the CAISO and other California Balancing Area Authorities to develop a mechanism to ensure that electricity imports subject to the cap and trade program match net interchange.

A second problem with the QE Adjustment is the new requirement that emission rate of the qualified export be equal to the emission rate of the cleanest import or export in that hour. Consequently, whenever the export portion is of lower intensity than the import portion or when there are multiple import transactions of varying intensity, the QE Adjustment would be less than the liability that could be avoided if the transaction were conducted as a wheel-through on a single tag – which are exempt from reporting. This inconsistent treatment creates an economic incentive for increasing use of the single tag wheel-through schedule types in the CAISO, instead of the more flexible simultaneous import/export schedules, thereby increasing economic inefficiencies without reducing GHG emissions.

WPTF submits that the requirements for the calculation of the emission intensity for the QE Adjustment are overly restrictive, unnecessary and inconsistent with the treatment of wheel-throughs. We therefore recommend the following change to paragraph (5) of section 95852(b):

(A) During any hour in which an electricity importer claims qualified exports and corresponding imports, the maximum amount of QE adjustment for the hour shall not exceed the product of:

1. The lower of either the quantity of exports or imports (MWh) for the hour; multiplied by
2. The weighted average lowest emission factor of any portion of the qualified exports or corresponding imports for the hour. If the quantity of qualified exports is less than the quantity of corresponding imports for the hour, then the weighted average is calculated by ranking the imports in intensity from highest to lowest and applied to the volume from subsection (1) accordingly.