INDEPENDENT
ENERGY
PRODUCERS

October 10, 2011

Mary Nichols, Chair
California Air Resources Board
P.O. Box 2815
Sacramento, CA 95812

Re: Problems with GHG C&T and Mandatory Reporting Draft Review Language

Dear Ms. Nichols:

The Independent Energy Producers Association ("IEP") represents over 26,000 MWs of installed electrical generation capacity owned and operated by Independent Power Producers ("IPPs") in California. IEP supported AB 32 and has worked with the Air Resources Board ("CARB") in developing an efficient and effective Cap & Trade ("C&T") Program to reduce carbon emissions. We have been particularly focused on ensuring that the C&T Program supports a competitive, level playing field in the electric generation sector while minimizing so-called "leakage" of GHG emissions. The Western Power Trading Forum ("WPTF") is a broad-based membership organization dedicated to encouraging competition in Western states electric markets. It's goal is to reduce the long-run cost of electricity to consumers throughout the region, and maintain the current high level of system reliability.

Recently, the CARB released two documents: (a) *Second 15-Day Notice Affecting Article 5: California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms* ("Cap-and-trade Regulation"); and, (b) *Proposed Second 15-Day Modifications Affecting Subchapter 10: Climate Change and the Regulation For The Mandatory Reporting of Greenhouse Gas Emissions* ("Reporting Regulation"). Upon review of these regulations, IEP and WPTF believe that the proposed regulations create discrimination and anti-competitive outcomes in two key respects.

First, the Cap-and-trade Regulation fails to address the treatment of GHG allowance costs associated with IPPs (including Combined Heat and Power, i.e. "CHP") operating under pre-AB 32 contracts that have no reasonable means of cost recovery. By not responding to the Board's December 2010 Resolution on this issue,[1] the Cap-and-trade Regulation imposes a regulatory burden on a limited subset of IPPs that is not shared by our competitors, particularly utility-owned electric generators ("UOGs"). Furthermore, to exacerbate this situation, utilities are being provided free allowances on the assumption they are incurring GHG costs for services purchased under these IPP contracts when in fact no such costs are incurred. No policy or legal justification exists for marooning these in-state IPP generation assets operating under these contracts, nor providing windfall profits to the contract counterparties.

[1] Resolution 10-42 (December 16, 2010) provides: "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-AB32 long-term contracts that do not allow for pass-through of costs associated with greenhouse gas emissions." (Emphasis added)

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Second, the Cap-and-trade Regulations and Reporting Regulations, when taken together, provide unique and favorable treatment to a single importer, the Bonneville Power Administration ("BPA"), by assigning an emission factor that is 1/5 of the default factor applied to all other unspecified sources of imported energy. This discriminatory treatment is counterproductive to CARB's GHG emissions reductions goals, fosters "resource shuffling" and GHG emission "leakage" which CARB has sought to avoid, and unfairly creates a competitive advantage for BPA at the expense of all other obligated entities within the electric sector.

Background

Since adoption of AB 32, IEP has been steadfast in raising its concerns that a limited number of IPPs, including CHP operators, may not have a reasonable means of cost recovery of GHG allowances required to achieve compliance with the CARB's GHG emissions reduction program. As noted in IEP's previous comments, failure to address this issue is discriminatory and inconsistent with the policies underlying the Cap-and-trade Regulation. Indeed, we proposed in our comments a number of solutions to this problem. Despite numerous stakeholder comments and meetings, the Cap-and-trade Regulation remains stubbornly silent on the treatment of existing, long-term contracts that have no reasonable means of cost recovery of GHG allowances. Rather, these IPPs are expected to renegotiate their contracts with counter-parties that have no incentive to do so and, indeed, may have lots of incentives to avoid renegotiation even though they have the means to pass those costs to the ultimate energy consumer through rate-base or the market.

In contrast, other obligated entities in the electric sector (as well as the industrial sector) are provided their allowances directly or indirectly at no cost even when they have a reasonable means of market-based and/or rate-based cost recovery. When a utility-owned generator ("UOG") enters an auction to purchase allowances to meet its compliance obligation, the expenditures it makes as an electric generator are recovered through ratemaking on a dollar-for-dollar basis. Furthermore, the revenues associated by the UOG allowance purchases flow back to the same utility in its function as an electrical distribution utility, which originally received the auctioned allowances for free based on its expected costs under the Cap-and-trade Regulation. Thus, the utility as owner of the UOG asset is indifferent to the GHG cost increase associated with UOG operations. Yet, this is not the case for the IPP, which is in competition with the UOG, as the IPPs cannot rate-base their allowance purchases. We find the explicit refusal of CARB to address this issue as unreasonable, unfair and discriminatory.

In addition to this concern, the Cap-and-trade Regulation creates a special class for a single electricity importer, the Bonneville Power Administration ("BPA"), and then the Reporting Regulation affords BPA favorable treatment in the calculation of GHG emissions associated with imported power to California by applying a default emissions factor that is 1/5 of that applied to all other unspecified imports. Not only does this language favor BPA in comparison with other importers, but the unique treatment afforded BPA may favor BPA versus in-state electric generation assets and contribute to the "leakage" that CARB and AB 32 sought to avoid. Moreover, this favorable treatment will create opportunities for "resource shuffling" where importers will seek to sell their power through BPA because BPA has such a low emissions factor. This result is counter-productive to CARB's emission reduction goals.

IEP/WPTF Recommendation

First, to supplement the Board's December 2010 directive to remedy the fact that the Cap-and-trade Regulation fails to address or even acknowledge the limited set of IPP electric generators (and CHP operations) operating under pre-AB 32 existing contracts without an ability to pass-through the costs of

GHG allowances, ***the CARB Board now should direct the staff via resolution to address this matter immediately, prior to the first auction of GHG allowances, so these IPPs are treated in a practical, reasonable and comparable manner to all other obligated entities in the electric sector from the perspective of cost recovery of GHG allowance costs.***

The options to achieve this outcome include the following:

- Shifting the compliance burden to the contract party that can recover compliance costs through the market or via ratemaking; or

- Provide free allowances in the case that neither party can effectively recover costs through the market.

Second, the proposed regulations treat a single entity, BPA, in a unique and beneficial manner when compared to all other obligated entities in the electric sector in the context of calculating GHG emissions from specified and unspecified resources [Section 95111(b)(3)]. Providing a "regulatory carve out" for a single entity such as BPA is effectively discriminating against all other supplies. ***The CARB Board should direct staff to eliminate this unique and favorable treatment, thereby treating all obligated entities in a comparable and non-discriminatory manner when calculating GHG emissions for specified and unspecified imports.***

Thank you for your consideration of this important matter.

Respectfully submitted,

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WPTF Executive Director

cc: Board Member Dr. Daniel Sperling
Board Member Dr. Ken Yeager
Board Member Dorene D'Adamo
Board Member Barbara Riordan
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Board Member Lydia Kennard
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