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Mary Nichols, Chairman
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: **Comments of the Northern California Power Agency on** ***Proposed AB 32 Cost of Implementation Fee Regulation***

Dear Kevin:

The Northern California Power Agency[1] (NCPA) offers these comments on the *Notice of Public Hearing to Consider Adoption of a Proposed AB 32 Cost of Implementation Fee Regulation* (Fee or Proposed Regulation) and the *Staff Report: Initial Statement of Reasons for Rulemaking* (ISOR or Rulemaking), issued by the California Air Resources Board (CARB) on May 8, 2009. The Rulemaking would adopt new Article 3, sections 95200 to 95207, to Title 17 of the California Code of Regulations, and would be termed the "AB 32 Cost of Implementation Fee."

I. Introduction

Assembly Bill (AB) 32 authorized CARB to create a "schedule of fees to be paid by the sources of greenhouse gas [GHG] emissions."[2] In the ISOR, CARB sets forth the proposed structure for the Fee, which imposes the obligation for payment of the fee on "upstream entities, which can then pass on the cost of the fee by increasing the cost of the fuel supplied to downstream entities." (ISOR, p. 13) Included in the upstream sources upon which the Fee is to be imposed is imported electricity.

AB 32 authorized CARB to impose the fee, and there can be little doubt that the State needs a source of income to support its efforts in implementing the wide range of emissions reduction

1 NCPA 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, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

2 Health & Safety Code § 38597 provides: "*The state board my adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001. The revenue collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division.*"

strategies proposed in the Scoping Plan. One essential element that is missing from the ISOR, however, is any discussion regarding a potential cap for the total amount of the Fee. As more fully set forth below, the fact that the Fee will be set in place to collect *whatever amounts* the state agencies may require in the coming years is problematic for the entities that will be required to pay the Fee. Regardless of the current amounts due, the Fee has the potential to be large, and emphasize the need to address some of the details regarding the manner in which the Fee is implemented, and its impacts on various sectors of the economy. NCPA fully supports the notion that the imposition of the Fee should be as administratively simple as possible (indeed, a complex Fee structure would only result in an even greater overall Fee obligation). However, such simplicity should not be achieved at the cost of a select few compliance entities.

Accordingly, NCPA is very concerned with conclusions in the ISOR that reference the de minimus impacts of the proposed Fee, the benefits of administrative simplicity over accuracy, and the fact that the amount of the Fee is perceived to be insufficient to adversely impact behaviors. With CARB only at the nascent stages of implementing the provisions of the Scoping Plan, the total amount of the Fee obligation from year to year is not known. Hence, any reference justifying the structure of the Fee based on the overall amount must be disregarded.

II. Applicability

Pursuant to § 95201(a), the Fee would be imposed on certain "entities." AB 32 requires that the Fee be imposed on *sources* of greenhouse gases, yet as drafted, the Fee would not be imposed on the sources of greenhouse gas, but rather on the underlying fuels.

A "fee" imposed on only a few entities is actually deemed a tax.[3] Since CARB's Fee is designed around the premise that the costs will be passed through to end users, the Proposed Regulation attempts to meet the requirement of a fee, rather than be a tax. The ISOR states that CARB believes upstream suppliers are, in fact, sources of GHG emissions upon which the Proposed Regulation may be imposed. (ISOR, p. 35) CARB asserts that imposition of the Fee on these upstream sources of GHG emissions meets the nexus necessary under California law to avoid the fee being deemed a tax.[4]

The ISOR notes that "<u>some</u> of the entities on which fees are imposed are clearly 'sources' of greenhouse gas that are directly emitted into the atmosphere." However, as it pertains to natural gas and transportation fuels, the ISOR argues that "the proposed regulation is <u>simply an administrative mechanism</u> for efficiently collecting fees on downstream 'sources' of greenhouse gas emissions based on the <u>assumption</u> that the costs of the fees will be passed on to downstream end users who actually combust the natural gas and transportation fuel." (ISOR, p. 35, emphasis added) A mere *assumption* is not sufficient to substantiate the claim that the Fee is actually being imposed on the source of greenhouse gas emissions. For natural gas, gasoline, or diesel fuels, the ISOR notes that it would be "inefficient, impractical and overly burdensome to impose fees on all

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3 *Sinclair Paint Co. v. State Board of Equalization,* 15 Cal.4th 866 (1997).

4 Id., at 877-878.

of the individuals" that operate equipment that burn these fuels. When read literally, this statement supports the position that the proposed Fee is more analogous to a tax, and not the position that the upstream sources of the underlying fuels are in fact, "sources" of GHG emissions as contemplated in AB 32.

Furthermore, CARB's assumption of pass-through of the Fee is neither explicit in the proposed language, nor implicit in the operations of affected entities. In the absence of an appropriate pass-through, the Fee results in a disproportionate distribution of the costs of administering the Scoping Plan and the AB 32 emission reduction measures to limited sectors and entities.

III. Economic Impact Analysis

A. The Fee is Based on an Uncapped Revenue Amount

As noted in the ISOR, the total amount of the proposed Fee is unknown for future years. The Fee itself, as well as the underlying economic analysis, is based on current budget levels that may be changed by the Legislature. (ISOR, p. 42) Furthermore, the Proposed Regulation is largely based on the Nonvehicular Source Fee Program (NVSF) that was developed as a result of 1999 legislation (Assembly Bill 1103), which extended indefinitely CARB's authority to collect permit fees from large nonvehicular sources of air pollution. While there are aspects of the NVSF that are similar to the Proposed Regulation (this fee is "intended to help defray the ARB's cost of implementing the nonvehicular provisions of the [California Clean Air Act]"[5]), there is an important difference in that the NVSF is based on a *capped amount*, not subject to annual adjustments. This distinction is crucial.

In the Proposed Regulation, the total amount of the revenue requirement is uncapped. Affected entities' total Fee obligation can potentially fluctuate widely from year to year and it is inevitable that the total amount of the Fee will only increase as implementation of AB 32 becomes more complex, and rigorous monitoring and enforcement mechanisms are implemented. The fluctuating and uncapped obligation becomes especially problematic when entities are trying to budget for their annual fee obligation, or determine the manner in which to pass the costs along to end users (this is also discussed below in the context of § 95206, Payment and Collection).

B. There is No Guarantee the Affected Entities Can Pass-Through the Costs of the Fee

The Proposed Regulation is based on the premise that the costs will be passed along to end users. In the ISOR, CARB "*expects that most businesses paying the Fee*" will be able to pass the costs through to consumers. (ISOR, p. 46) However, there is no real data to support this supposition, nor the impact of this pass through on consumers. As it pertains to repayment for past amounts, the costs associated with the retroactive bill amounts cannot necessarily be captured in a pass-through. A realistic analysis of the economic impact must consider the impact directly on the

[5] 2002-2005 CCAA Nonvehicular Source Fee Program Overview, October 17, 2008.

upstream entity charged with paying the Fee to the State, and not merely the disbursed amount of that Fee if pass-through is possible.

C. Impacts of the Fee on Electricity Imports Are Not Substantiated

The ISOR notes that "electric importers . . . should be able to pass the Fee cost on to the load-serving entities. The load-serving entities can then recover the passed-through Fee cost as a price increase over all of their deliveries. ARB believes that the imposition of the Fee is too small to affect wholesale market dispatch." (ISOR, p. 46) There is no underlying data, however, to support this conclusion. Since the Fee would not be imposed on electricity generated in-state, the pass-through of the Fee for imported electricity will not impact all retail providers or load-serving entities in the same way. Some load-serving entities have long-term contracts and obligations that require them to take the imported electricity, whereby subjecting them to greater cost burdens under the current Proposed Regulation. There is no data to support the supposition that the impact of the fee on retail providers will be "too small to affect wholesale market dispatch."

IV. Imported Electricity

The ISOR notes that the AB 32 Fee would apply to imported electricity that is consumed in California. (ISOR, pp. 24, 51) Proposed § 95201(a)(5) provides that the Fee applies to "any retail provider or marketer that is the purchasing/selling entity at the first point of delivery in California of imported electricity. Fees shall be paid for each megawatt-hour of imported electricity." The ISOR opines that:

> *"it is necessary to include importers of electricity because the out-of-state generation of electricity to supply California consumers results in greenhouse gas emissions. These emissions must be included in the Fee base to ensure the widest possible base of fee payers. This method will result in a fee that is equitable to that proposed to be assessed on in-state electricity, however the method is different because ARB does not have the authority to regulate providers of fuel to electricity generators located out-of-state."*
> (ISOR, p. 51)

However, this rationale does not negate the fact that the Fee is being imposed on imported electricity and not on in-state generation, nor does it provide the necessary support for the assumption that the fee impact will be the same on both in-state and imported electricity.

A. The Proposed Regulation Violates the US Commerce Clause by Including Imported Power

CARB supports the inclusion of imported power on the premise that it would allow for the Fee to be spread across a larger segment of the economy, capturing more emissions sources, and ostensibly reducing the cost burden on any one sector or industry. (ISOR, pp. 8, 12, 14, 49) By imposing the Fee on the entities responsible for importing electricity into the State, CARB

anticipates that it can capture approximately 85% of all greenhouse gas emissions sources contributing to pollutants in the State.

Inclusion of imported power within the sources responsible for payment of the Fee creates disparate treatment of imported versus in-state electricity, as the Fee is not imposed on electricity generated within California. This facially discriminatory treatment likely violates the Commerce Clause of the United States Constitution (U.S. Const., Art I §8, cl. 3.) The Proposed Regulation creates a structure that discriminates against out-of-state electricity, which is contrary to the Commerce Clause.

B. The Proposed Regulation Applies the Fee to Imported Power Not Consumed in California

As drafted, the Proposed Regulation would impose the Fee on power that is imported into California, but never consumed in the State. Such an outcome is inconsistent with the exception set forth in proposed § 95201(b)(9) that specifically excludes application of the Fee to "any fuel exported for use outside California." Proposed § 95204(g) (addressing reporting requirements for imported electricity) states that the entity is to report "the total quantity of MWh of electricity imported . . . with a final point of delivery in California." The reference to final point of delivery in California within the reporting requirements would appear to address only power consumed in the State. In its most basic sense, most people associate power imported but not consumed in California as power that is "wheeled" through the state. The common definition of wheeled power includes bringing power in at a single point, and exporting that same power at a different point.[6]

However, this definition alone would not cover all power that is imported, yet not consumed in California. Imported power is sometimes purchased pursuant to existing contracts, yet is not needed to meet customer load. That power – or similar power – may be subsequently sold out-of-state. As drafted, the Proposed Regulation does not properly exclude imported/exported power that does not meet the definition of wheeled power. CARB has noted that it is necessary to assess the Fee on imported power, *even if* it is subsequently exported and not consumed in California because AB 32 requires the tracking of all GHG emissions for electricity generated in California and imported for consumption in the State.

This logic is belied by CARB's proposed application of the Fee in a manner that does not treat all electricity equally. Electricity imported into California is assessed the Fee based on the actual volume imported. Electricity generated in California is not assessed a Fee. Rather the Fee is assessed against the underlying fuel source used to generate the electricity. Accordingly, CARB's failure to recognize the net power consumed in California fails to acknowledge its own assessment scheme as it pertains to the Proposed Fee (i.e. fuel fee versus power fee), which is unique and distinguished from the way in which GHG emissions are counted or reported to the State. This important distinction must be recognized in the Proposed Regulation in order to

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6 Mandatory Reporting Regulation § 95111(b)(C) addresses reporting "Power Wheeled Through California."

ensure that electricity providers are not assessed a greater amount of the Fee than warranted to address the amount of imported power consumed in California.

C. <u>Failure to Recognize Net Electricity Imports Adversely Impacts Efficiency of the Electricity Market</u>

If the Fee is imposed on all electricity imports without recognition of the electricity actually consumed in California, CARB risks jeopardizing the efficient and reliable provision of electricity throughout the State. The purpose of transactions that allow imported electricity to

enter the State and at one point, change ownership, and be exported back at a different location is to leverage the most effective operation of the entire western electric transmission system, based on transmission constraints, differing peaks, and time of operating various facilities. This promotes efficiency not only in California, but throughout the entire western region. If entities know that they are going to be assessed an additional Fee on this electricity, they will be less motivated to act to promote the greatest efficiencies, but rather will need to adjust their transactions to address the need to avoid the unwarranted imposition of the Fee. Such an outcome should be avoided, and *can* be avoided by adjusting the proposed Fee to reflect that the charge will only be assessed against the <u>net</u> electricity imports, which actually reflects the electricity *consumed in California*.

D. <u>Use of Default Emissions Factors Could Penalize Certain Entities</u>

The ISOR proposes the use of default emissions factors for calculating the amount of the Fee on electricity imports from unspecified contracts. (Proposed § 95203(e)) Because use of the default emissions factor has the potential to adversely impact entities that have unspecified power contracts that come from geographic regions with a known emissions factor of less than 1,100 pounds of CO_2 per MWh, CARB should include a provision referencing the fact that regional or other default factors will be used in the future when they are adopted by the Agency.

V. Impacts of the Reporting Regulations on Determination of the Fee Obligation

A. <u>Reporting Regulation Does Not Properly Capture Wheeled Power Exclusions</u>

Not only does the Proposed Regulation not reflect the fact that power imported into California is not always consumed in California, neither do the existing Reporting Regulations capture the "net" of the total power imported. Accordingly, as drafted, electric retail providers may be assessed the Fee for electricity imports that are not subsequently consumed in the State. Entities are required to submit, consistent with the existing Reporting Regulation, the total quantity of imported power "with final point of delivery in California." The Reporting Tool, which CARB intends to require entities to use for purposes of meeting their reporting obligations under the statute, does not allow entities to properly categorize imported power as "wheeled power." Despite the provisions of proposed § 95202(45) that defines "imported electricity" as:

> *"Electricity that is generated outside of California and delivered into California. Imported electricity does not include power wheeled through California, which is power that is imported into California that terminates in a location outside of California."*

Under the Reporting Tool, entities are required to mark such electricity as "imported" and not merely "wheeled." To rectify this situation, which imposes a double burden for the Fee on entities that merely bring power through California, the Reporting Regulations should be revised to accommodate the need to exclude the power not consumed in California from the Fee calculation. Specifically, §95111(b) and (c) must be revised to ensure that these provisions do not prevent retail providers from reporting the net imported electricity for purposes of determining the amount of the Fee.

B. The Fee is Based on Test-Year Data

While CARB's need to move forward with imposition of the Fee as soon as possible may be understandable, it is still problematic at this juncture. One such manner is the fact that the Fee is being assessed – with no opportunity for correction or true-up – based on what is essentially test year data. The Reporting Regulations and the Reporting Tool are being tested for the first time in 2009, and indeed this year there is no requirement for validation of the results. As such, inadvertent reporting errors could result in the payment of Fees by some entities in excess of what their actual obligation should be, while other entities may end up paying less than their actual responsibility. The data used for the Fee calucation should be verified or subject to future correction, and refund, if applicable.

C. Point of Reporting for Natural Gas

The Reporting Requirements should be revised to clarify the point along the transmission system of natural gas at which CARB will assess Fees based on usage data.

VI. Payment and Collection of the Fee

A. The Proposed Regulation Provides Insufficient Time to Remit the Fee

In proposed § 95205, the Regulation seeks annual payment of the Fee obligation from affected entities within 60 days of being noticed of the amount due. The amount due, revised annually and based on an unspecified and uncapped amount, has the potential to vary greatly from year to year, making estimating the total annual obligation problematic. Depending on the amount of the Fee due, 60 days is likely not sufficient time for entities to collect and remit the necessary funds, especially for the first year.

This problem is further exacerbated by the fact that the fees proposed will be initially borne by a small segment of the economy, in anticipation of having the amounts passed-through to end users. In order to realize the pass-through, affected entities must be given adequate time to bill and

collect the amounts due from their customers and end users. Passing through the costs will require that entities include an additional line-item on their invoices for the initial transactions. Since the Fee covers a 12-month period, it would take at least 12 months for entities to recover the amounts that owed the State. Requiring these amounts to be paid within two months of receiving a Fee notice is unreasonable. Affected entities must be given sufficient notice of their annual compliance obligation to develop a revenue stream to pay those costs, a task not easily accomplished in all instances since those being called upon to pay the current fee will not be the same customers upon which the relevant data reported to CARB was based.

B. The Fee is Based on an Uncapped Amount

Unlike the NVSF upon which the Fee calculation is based, the fee at issue is not subject to a statutorily established cap, nor an open review and approval process. While the Fee is set for the next three years, the legislature can change the amount due annually, depending on the budgets submitted by the various state agencies, and indeed, even the State agencies eligible to receive funding under the Fee may change. For the average stakeholder – even sophisticated businesses – the opportunity for meaningful participation in the budget review process of any one agency, let alone at the legislature – is non-existent. Accordingly, those that will be burdened with the requirement to pay the Fee will have no opportunity to provide meaningful input on the amount of the Fee.

Even in future years, it will not be possible for entities to plan ahead for subsequent Fee determinations, as there are no checks or limitations on what the state's revenue needs are going to be. Since the revenue requirement is used in the calculation, it would be impossible for an entity to even estimate the total obligation and begin "passing through" a further expenditure to its customers. It is imperative that entities be given adequate time between the notification of the total annual assessment and the due date.

The AB 32 Fee must be revised to allow for the collection of the Fee in monthly or quarterly payments. This would allow the affected entities to reconcile their current budget and pass-through collection with payments to the state.

C. Proposed Section 95205(d) Should be Clarified

The amount of the late fee referenced in § 95205(d) must be more clearly defined. The Proposed Regulation must provide clarity with regard to what the Board's "additional expenses incurred by the entity's untimely payment" may be.

D. Provisions Should be Added to Address Resolution of Disputes

The Proposed Regulation includes no provision for timely review of potentially disputed amounts owed, despite the inclusion of proposed § 95026 regarding enforcement and the imposition of penalties. A new section § 95205(f) should be added to include a procedure for addressing

disputed amounts. At a minimum, the new section must allow affected entities at least 30 days from the date the written fee determination notice is received to review the amount due and submit a written notice of dispute to CARB. Such a provision should also include a stay on collection of the Fee, and imposition or accrual of any late fees (proposed § 95205) or penalties (proposed § 95026) pending good faith resolution of such disputed amount.

VII. Elimination of the Administrative Fee with Cap-and-Trade

The Rulemaking should clarify that the Proposed Regulation will only be an interim funding measure, and that the Fee will be revised to ensure that there is no duplication in collection, and to determine if the Fee should be adjusted, reduced, or eliminated in its entirety with the implementation of the proposed cap-and-trade program. Because the Proposed Regulation could result in significant amounts, the need for the Fee, as well as possible alternative funding sources, should be reviewed in the context of a cap-and-trade program. Since it is anticipated that the cap-and-trade program will generate revenue for the State, consideration should be given to utilizing some of those revenues to fund the implementation of AB 32, and eliminate the Fee.

VIII. Treatment of Renewable Energy Resources

A. Proposed Regulation Should be Clarified to Note that Imported Electricity From Renewable Energy Resources are Not Subject to the Fee

The proposed Fee does not state unequivocally CARB's intent that renewable energy not be subject to the Fee. The Proposed Regulations should be revised to clearly state that the Fee is not imposed on renewable energy, including renewable energy generated from large hydroelectric facilities, nor on null power.

B. Renewable Gas Should Not be Subject to the Fee

The Proposed Regulation should be amended to address instances in which renewable gas, such as biogas, is injected into the same pipeline as natural gas to ensure that the Fee is not assessed on the biogas resources. In order to effect this clarification, the Proposed Regulation should be revised to include an exception for biogas in proposed § 95201(b), which lists the exceptions to the applicability of the Fee. Entities that have biogas in the pipeline would be able to verify those amounts, and any Fees that would otherwise be applicable would be credited against any Fee obligation of the compliance entity. Failure to recognize biogas and other "renewable" fuel sources as not being subject to the Fee has the potential to adversely impact the behavior of those seeking renewable energy resources. Indeed, investments in biofuel projects would be avoided, hampering the ability of retail energy providers to meet not only their AB 32 compliance obligations, but also the ever increasing mandate to increase the procurement of renewable energy resources.

IX. Clarification Regarding Repayment Period

The ISOR states that payback of the 2007/2008 and 2008/2009 loans used to carry out AB 32 will be accomplished over the course of the next four years: 2009/2010, 2010/2011, 2011/2012, and 2012/2013. (ISOR, p. 30). Proposed § 95203(a)(2) provides that:

> *For Fiscal Years 2009/2010, 2010/2011, 2011/2012, 2012/2013, and 2013/2014, the RR shall also include the payments required to be made by ARB on the Debt.*

The Proposed Regulation must be corrected to clarify the repayment period discussed on page 30 with the five year repayment period set forth in proposed § 95202(a)(2).

X. Conclusion

While the proposed Fee is necessary to cover the State's costs associated with implementation of AB 32 and Scoping Plan programs, CARB is asking entities that are already contemplating significant costs associated with meeting their own mandated reductions to pay the Fee. Accordingly, it is imperative that the Fee be designed not only to meet CARB's goal of administrative simplicity, but must also accurately capture the intended scope of the Fee obligation on various entities and the impacts that the manner in which the Fee is proposed will have on the efficient operation of the electricity grid throughout the west. Because the Fee is designed to be applied only to upstream sources, the ability to pass-along the cost as proposed by CARB is not inherent in the structure of the Proposed Regulation, regardless of the CARB's intent. Accordingly, application of the Fee must be justified based on the overall fairness of the Fee, and not based on arguments that the impacts on individuals will be de minimus.

NCPA appreciates the opportunity to submit these comments to CARB, and urges the Board to carefully review the issues raised herein before approving the adoption of the AB 32 Cost of Implementation Fee as currently proposed. 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,
MCCARTHY & BERLIN, LLP

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