BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY SUPPLEMENTAL COMMENT ON PROPOSED AB 32 IMPLEMENTATION FEE REGULATION

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Dated: September 23, 2009

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The Southern California Public Power Authority ("SCPPA")[1] respectfully submits this supplemental comment on the May 8, 2009 Initial Statement of Reasons ("ISOR") for a regulation establishing fees to support the implementation and administration of Assembly Bill ("AB") 32 by the Air Resources Board ("ARB"). This supplemental comment is prompted by a white paper entitled "Proposed Regulatory Changes to the AB 32 Cost of Implementation Fee – Electricity" ("White Paper"), which was prepared for a workshop that was convened by the ARB staff on August 25, 2009, and by a revised draft of the proposed regulations that was released by the ARB staff on September 14, 2009 ("Revised Draft Regulations"). SCPPA previously filed comments on the proposed implementation fee regulations on June 18, 2009 and September 3, 2009.

The White Paper and Revised Draft Regulations attempt to treat in-state and imported electricity more consistently than proposed in the ISOR. However, some problems remain with the application of the proposed fees to imported electricity. First, the proposed fees would be assessed on both the emissions associated with electricity that is imported into California under exchange agreements and the emissions associated with electricity that is exported under exchange agreements. Assessing fees on both exchange import emissions and exchange export emissions would discourage parties from entering into arrangements to benefit electricity consumers and society as a whole by reducing the cost of generating electricity, and it conflicts with the Commerce Clause of the U.S. Constitution. Second, it remains unclear whether the

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[1] SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Imperial Irrigation District, Pasadena and Riverside.

proposed fees would apply to arrangements in which electricity is transmitted or "wheeled" through California under buy/sell arrangements without being consumed in California.

As discussed below, SCPPA proposes that the regulation be modified to avoid the imposition of the fee on exchange import emissions to the extent that fees are paid on exchange export emissions. SCPPA also proposes that the regulation be modified to assure that there will be no imposition of the administrative fee on emissions associated with electricity that is wheeled through California under buy/sell arrangements.

The White Paper and Revised Draft Regulations do not address several other issues which SCPPA has raised in its previous comments. Insofar as SCPPA discussed these concerns in its prior comments, SCPPA does not address them further here, but SCPPA urges the Board to consider the issues:

- Applying an administrative fee on imported electricity would be inconsistent with Health & Safety Code ("HSC") section 38597, the section that authorizes the ARB to assess administrative fees. That section specifically provides for fees to be paid by *sources* of greenhouse gas emissions, but neither imported electricity nor the act of importing electricity are a source of emissions. Although the AB 32 definition of "statewide greenhouse gas emissions" in HSC § 38505(m) includes emissions associated with imported electricity, the Legislature elected not to write HSC section 38597 so as to authorize fees to be assessed on "statewide greenhouse gas emissions." Rather, HSC section 38597 was written to authorize "fees to be paid by the *sources* of greenhouse gas emissions regulated pursuant to this division…." The difference is significant and should be recognized by limiting the fees to sources. *See* SCPPA June 18, 2009 Comment, pp. 4-7.
- Assessing the fee on imported electricity "at the first point of delivery of electricity" would be preempted under the Federal Power Act. The FPA grants exclusive jurisdiction over

wholesale sales of electricity in interstate commerce to the Federal Energy Regulatory Commission ("FERC"). Federal preemption of the field of wholesale transactions goes well beyond pricing issues. The FERC regulation of wholesale power attaches to all aspects of a jurisdictional seller and a jurisdictional transaction. The application of the administrative fee to wholesale sales of electricity "at the first point of delivery in California of imported electricity" would intrude into a federally occupied field and would be unlawful. *See* SCPPA June 18, 2009 Comment, pp. 14-16.

- Cogeneration facilities should be treated like other generation facilities, with fees assessed directly on the basis of total emissions. The White Paper proposed that cogeneration facilities "would be treated as industrial facilities, with fees assessed to their fuels or on their emissions, but not on their electricity." This is reflected in the Revised Draft Regulations at section 25201(a)(4)(C): "No fee shall be paid for any megawatt-hour of electricity generated at a cogeneration facility." As a result, electricity that is delivered to the grid by generators would bear the burden of a direct imposition of the administrative fee, but electricity that is delivered to the grid by cogenerators would not bear the fee except indirectly the extent that upstream fuel suppliers elect to bill cogenerators to recover the supplier's cost of paying the fee to ARB. Staff has not presented any cogent rationale for discriminating between cogenerators and generators. Just as the fees can be directly assessed on the emissions from generation facilities, fees could be directly assessed on emissions from cogeneration facilities. *See* SCPPA September 3, 2009 Comment, pp. 11 – 12.
- The Board should set a cap on the revenues that would be collected through the administrative fee. Section 95303(a) defines the "Total Required Revenue" ("TRR") that would be recovered annually through the administrative fee. It appears from section 95303(a) that the primary parameter for determining the TRR would be "the number of

personnel positions, including salaries and benefits and all other costs, as approved in the California Budget Act for that fiscal year." Appendix C to the ISOR lists a plethora of programs for which funding would be provided through the administrative fee. The list and the accompanying staffing requirements could grow substantially in the future unless there were some reasonable constraint on the TRR that could be recovered each year through the administrative fee. SCPPA encourages the Board to adopt a provision for a reasonable cap that would apply to administrative fees. *See* SCPPA June 18, 2009 Comment, p. 20

I. THE PROPOSED REGULATION SHOULD BE MODIFIED SO THAT THE ADMINISTRATIVE FEE WOULD NOT BE APPLIED TO BOTH THE IMPORT SIDE AND THE EXPORT SIDE OF ENERGY EXCHANGE ARRANGEMENTS.

SCPPA recommends that the Board revise the proposed fee regulation and make appropriate conforming changes to the Mandatory Reporting Regulation so that the emissions that are associated with electricity that is imported under an exchange agreement with an out-of-state counterparty would not be subject to the fee to the extent that the emissions are offset by the emissions associated with electricity that is exported to the counterparty under the exchange agreement. The application of the proposed fees to interstate exchange arrangements would discourage arrangements that benefit society by reducing the cost of electricity generation and would discriminate against interstate commerce in violation of the Commerce Clause of the U.S. Constitution.

A. Charging the Fee on Both the Import Side and Export Side of Exchange Arrangements Would Discourage Arrangements that Benefit Society.

Electricity exchanges are important tools that are used by retail providers to reduce the cost of electricity for the benefit of electricity consumers and ultimately society as a whole. Exchange arrangements between retail providers are contractual tools that permit the timing of generation by each retail provider to be changed so that each retail provider can generate electricity at a time when it is cheaper for the retail provider to generate electricity. In the absence of an exchange agreement, each retail provider is required by the laws of physics to generate electricity at precisely the same time that demand occurs in its service territory. An exchange arrangement permits each retail provider to maximize the efficient use of generating resources by generating electricity non-coincidentally with demand in its service territory instead of generating coincidentally with demand. Even though the timing of generation is changed so that generation occurs at a time that is non-coincidental with demand, each retail provider still produces only one kilowatt hour of electricity to meet one kilowatt hour of demand in a typical exchange situation.

Exchanges often involve counterparties that are located outside of California in, for example, the Pacific Northwest ("PNW"). It might be more costly for a California party to generate electricity at a time when it is less costly for the PNW party to generate electricity. Conversely, it might be less costly for a California party to generate electricity when generation is more costly for the PNW party. An exchange arrangement enables the PNW party to generate when its costs are lower and permits the California party to generate when its costs are lower. The result is a more efficient use of generation resources by both retail providers.

As proposed by the staff, the administrative fee would tend to discourage California retail providers from entering into exchange agreements with out-of-state counterparties. If a California retail provider meets a kilowatt hour of its local demand using its own local generation then a fee would be imposed on the emissions associated with generating only one kilowatt hour of electricity.

However, a California retail provider enters into an exchange arrangement with a PNW counterparty, the California retail provider would be charged two fees, once when electricity is delivered to California from the PNW and again when electricity is returned to the PNW from California. The double assessment of administrative fees would discourage retail providers from realizing the efficiencies that can be gained from entering into exchange agreements. Discouraging retail providers from realizing efficiencies for the benefit of electricity consumers and society as a whole would be poor public policy.

B. The Proposed Regulation as Applied to Interestate Exchange Arrangements Would Discriminate Against Interstate Commerce In Violation of the Commerce Clause of the U.S. Constitution.

Charging the fee on emissions on both sides of interstate exchange arrangements discriminates against interstate exchange arrangements as opposed to intrastate arrangements. If a California retail provider enters into agreement with a California counterparty, the California retail provider would pay an administrative fee only when it generates electricity for delivery to its California counterparty. However, if a California retail provider enters into an exchange agreement with an out-of-state counterparty, the California retail provider would pay two administrative fees, once on the exchange import emissions and again on the exchange export emissions.

The burden on interstate commerce is further illustrated by assuming that other states follow California's lead and adopt similar administrative fees. If California were to apply administrative fees on both the import leg and the export leg of energy exchanges and, for example, Oregon were to do the same, Oregon would impose fees on exchange import emissions as well as exchange export emissions, and California would do the same. Thus, if two kilowatt hours were produced to meet two kilowatt hours of demand, one in California and one in Oregon, *four* charges would be assessed on exchange electricity, two by Oregon and two by California. If the California and Oregon retail providers avoided interstate exchange agreements and limited themselves to exchange agreements with counterparties in their own states, they would pay a total of two fees instead of four.

Thus, the proposed regulation would discriminate against interstate commerce by imposing additional fees upon interstate exchange arrangements in contrast to intrastate exchange arrangements. This would be unconstitutional.

The applicable constitutional principles were outlined in SCPPA's June 17, 2009 comments on the proposed regulation. In summary, the "dormant" Commerce Clause (U.S. Constitution, article I, §8, cl. 3) limits the power of a state to regulate or tax interstate commerce, even in the absence of federal legislation on the subject. State statutes and regulations which impose taxes or administrative fees on interstate commerce, including interstate transmission of electricity, are subject to Commerce Clause scrutiny. If a state law discriminates on its face against businesses operating in interstate commerce, the law is subject to strict scrutiny that the Supreme Court has described as "virtually *per se* invalid". *Oregon Waste Systems, Inc. v. Dep't of Environmental Quality*, 511 U.S. 93, 99, 114 S. Ct. 1345, 128 L. Ed. 2d 13 (1994). "When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry." *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 579, 106 S. Ct. 2080, 90 L. Ed. 2d 552 (1986).

The proposed fee regulation, by imposing more fees on interstate exchanges than intrastate exchanges, facially discriminates against interstate commerce. Consequently, the rule of virtual *per se* invalidity applies. The proposed regulation will be invalid unless it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Oregon Waste Systems*, 511 U.S. 93, 100-101, quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278, 108 S. Ct. 1803, 100 L. Ed. 2d 302 (1988).

In this case, there are reasonable nondiscriminatory alternatives. In order to avoid the unfair double imposition of administrative fees on exchanges of electricity, SCPPA has recommended to the staff that the ARB's Mandatory Reporting Regulation be amended to permit the reporting of exchanges as a separate category of transactions. *See* SCPPA's September 3, 2009 Comment at pp. 9 – 11. An interim remedy is also available to the Board, pending revision of the Mandatory Reporting Regulations. These changes, described in greater detail below, would allow for a more evenhanded treatment of interstate and intrastate exchange arrangements. Thus, there are reasonable nondiscriminatory alternatives to the proposed regulation, and the proposed regulation as applied to interstate exchange arrangements would not survive strict scrutiny under the dormant Commerce Clause.

1. Amending the Mandatory Reporting Regulations.

In order to avoid the imposition of the fee on both interstate exchange export emissions and interstate import emissions the Mandatory Reporting Regulation should be amended to permit reporting of exchanges. Specifically, SCPPA proposes that section 95111(b)(1)(A) of the Mandatory Reporting Regulation be modified so as to read as follows:

> 9. Energy Exchanges between California and Out-of-State Entities. ~~Specify~~ Report energy exchanges that involve importing and exporting electricity to and from California by counterparty, aggregated on an annual basis as follows: 1) electricity received under exchange agreements (as measured at the point of receipt, specifying the source if known or the region of origin), ~~as purchases~~ and 2) electricity delivered under exchange agreements (as measured at the point of delivery, specifying the source if known or the region of origin). ~~as wholesale sales.~~ The retail provider or marketer shall retain, for purposes of verification, exchange agreement contracts, NERC e-tags, settlement data, or other information to confirm the transactions. Energy exchanges that do not involve importing and exporting electricity to and from California are not subject to reporting.

This modification to the Mandatory Reporting Regulation would permit reporting of imports and exports under exchange arrangements as linked transactions which would enable ARB staff to subtract emissions associated with interstate exchange exports from emissions associated with interstate exchange imports. If that data were available to the staff, the staff could calculate administrative fees so that there would not be a payment of fees on both the emissions associated with interstate exchange exports and emissions associated with interstate exchange imports. *See* SCPPA's September 3, 2009 comments, at p. 9.

2. An Interim Measure Until the Mandatory Reporting Regulation Can Be Amended.

Staff has objected to modifying the Mandatory Reporting Regulation in this proceeding. *See* SCPPA September 3, 2009 Comment, pp. 9-10. Thus, SCPPA proposes an interim measure that should be taken until the Mandatory Reporting Regulation can be amended. To avoid the discriminatory impact on interstate exchanges, SCPPA proposes that for the period between the implementation of the administrative fee regulation and the effective date of a revision of the Mandatory Reporting Regulation, emissions associated with a reporting party's gross exports as reported under the current Mandatory Reporting Regulation should be subtracted from the emissions associated with the reporting party's gross imports for purposes of billing the administrative fee.

For SCPPA members, exchange exports are most if not all of their total exports during a given year. Thus, total exports would be a reasonable substitute to use for exchange exports for the period of time until the Mandatory Reporting Regulation can be revised to permit a precise offset of exchange export emissions against exchange import emissions.

II. THE PROPOSED REGULATION SHOULD BE MODIFIED TO ASSURE THAT THE ADMINISTRATIVE FEE WILL NOT BE APPLIED TO ARRANGEMENTS IN WHICH ELECTRICITY IS WHEELED THROUGH CALIFORNIA UNDER BUY/SELL ARRANGEMENTS WITHOUT BEING CONSUMED IN CALIFORNIA.

SCPPA recommends that the definition of "imported electricity" as proposed by the staff be revised to assure that the administrative fee will not be applied to electricity that is transmitted (wheeled) through California under arrangements for a simultaneous purchase and sale of electricity. *See* SCPPA's June 18, 2009 Comment, pp. 17 – 18, and SCPPA's September 3, 2009 Comment, pp. 3 – 6.

It appears clear that electricity that is wheeled through California by a retail provider without the retail provider taking title to the electricity at any point is excluded from being reported as "imported power" under the Mandatory Reporting Regulation, 17 Cal. Code of Regs. §95111(b)(1)(C), and that wheeled electricity would be excluded from being counted as "imported electricity" for purposes of assessing the administrative fee, pursuant to section 95202(a)(54) of the Revised Draft Regulations. S*ee* SCPPA's September 3, 2009 Comment, pp. 3 – 4.

However, a second way in which electricity may be transmitted through California without being consumed in California is through a simultaneous purchase and sale or "buy/sell" transaction. In such an arrangement, a retail provider or marketer might buy electricity from a party at a first point of delivery in California, transmit the power through California, and simultaneously sell the electricity to the same or even a different party at a different delivery point outside of California. Such transactions are sometimes called "virtual transmission" because they are functionally equivalent to wheeling power.

The ARB's mandatory reporting staff has provided oral guidance that for purposes of reporting under the Mandatory Reporting Regulation, all transactions that are functionally equivalent to wheeling power through California should be reported as "wheeled power" rather than as "imported electricity." Likewise, electricity that is transmitted through California under a buy/sell arrangement should be treated as wheeled electricity and should be excluded from application of the administrative fee. *See* SCPPA's September 3, 2009 Comment, p. 5.

However, the proposed section titled “First Deliverers of Electricity” appears to compel application of the fee in situations in which a retail provider or marketer transmits power through California under a buy/sell arrangement. To avoid any confusion, SCPPA recommends that the definition of “imported electricity” in the Revised Draft Regulations as circulated by staff on September 14, 2009 be modified so it will be clear that all power that is wheeled through California will be excluded from being treated as imported electricity for purposes of applying the administrative fee. SCPPA’s proposed modification of the definition in section 95202(a)(54) of the Revised Draft Regulations is as follows:

> (54) “Imported electricity” means electricity that is generated outside of California and delivered to a first point of delivery in California or electricity having a final point of delivery in California. Imported electricity does not include:
>
> (A) Power wheeled through California, which is power that is imported into California that terminates in a location outside of California; or
>
> (B) Power transactions ~~exchanges~~ in which imported power is simultaneously exchanged for exported power.

III. CONCLUSION.

For the reasons set forth above and in its previous comments, SCPPA recommends that the ARB revise the proposed regulation to eliminate the application of the fee to imported electricity in order to remove the inconsistency with HSC §38597 and to avoid federal preemption.

If the Board declines to eliminate the application of the fee to imported electricity, the Board should remedy the problems created by applying the fee to both the import and the export sides of exchange transactions by amending the Mandatory Reporting Regulation as proposed above. As an interim measure until the Mandatory Reporting Regulation is amended, the Board should revise the proposed fee regulation to provide that emissions associated with a retail provider's or marketer's gross exports as reported under the current Mandatory Reporting Regulation shall be subtracted from the emissions associated with the reporting party's gross imports for purposes of billing the administrative fee.

The Board should revise the definition of "imported electricity" as described above to be sure that the fee will not be applied to wheeling through under buy/sell arrangements. Lastly, the Board should revise the proposed regulation to ensure equivalent treatment of generators and cogenerators, and the Board should set a cap on the revenues that may be collected by the proposed administrative fees.

SCPPA appreciates this opportunity to submit these supplemental comments.

Respectfully submitted,

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