BEFORE THE CALIFORNIA AIR RESOURCES BOARD
OFFICE OF CLIMATE CHANGE

Proposed AB 32 Cost of Implementation Fee Regulation By Adoption of New Article 3, Sections 95200-95207, Title 17 California Code of Regulations	Noticed: May 8, 2009 Hearing Date: June 25-26, 2009

COMMENTS OF EL PASO NATURAL GAS COMPANY AND MOJAVE PIPELINE COMPANY ON PROPOSED RULEMAKING

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COMMENTS OF EL PASO NATURAL GAS COMPANY AND MOJAVE PIPELINE COMPANY ON PROPOSED RULEMAKING TO CONSIDER ADOPTION OF AB 32 COST OF IMPLEMENTATION FEE REGULATION

In accordance with the Notice of Public Hearing to Consider Adoption of a Proposed AB 32 Cost of Implementation Fee Regulation and the Proposed Amendment to the Existing Regulation for the Mandatory Reporting of GHG Emissions, as noticed by the California Air Resources Board ("CARB") on May 8, 2009, El Paso Natural Gas Company ("EPNG") and Mojave Pipeline Company ("Mojave") hereby respectfully submit their joint comments. EPNG and Mojave appreciate the opportunity to provide their comments on the proposed fee regulation.

Introduction and Background

The EPNG and Mojave pipeline systems transport over 30% of the natural gas consumed in California.[1] The two companies are subsidiaries of El Paso Corporation (collectively, "El Paso"). El Paso's pipeline group operates a network of nearly 43,000 miles of pipeline, comprising over 20% of the interstate gas pipeline infrastructure in the United States. El Paso has operations in over 30 states.

El Paso currently helps satisfy, and will continue to help meet, California's growing demand for clean-burning natural gas through its extensive network of natural gas pipelines and future natural gas projects. As an industry leader, we share the concerns expressed by public and governmental stakeholders over the issue of greenhouse gas emissions and anthropogenic climate change. El Paso has actively participated in national and international policy discussions, and it has instituted its own internal guiding principles on the issue of global climate change. Our commitment in this

[1] EPNG and Mojave are "open access" interstate pipelines subject to federal rather than California state utility commission jurisdiction. The natural gas delivered in their systems is owned by others.

regard carries out our Core Value of Stewardship as we strive always to be good stewards of the Earth.

El Paso has been a member of the California Climate Action Registry (CCAR) since 2006. In June 2007, El Paso became the first natural gas transmission company to file an emissions inventory covering all applicable GHGs, including methane, N_2O and CO_2. On July 16, 2007, El Paso became the first natural gas transmission company to certify its emissions and earn the status of Climate Action Leader. El Paso has been an active participant in the development of California regulations related to GHG emissions and has commented extensively in the California Public Utilities Commission (CPUC) and California Energy Commission processes. El Paso is also active in the Western Climate Initiative (WCI) process, and EPNG is a Founding Registrant of The Climate Registry (TCR).

The California Global Warming Solutions Act of 2006, Assembly Bill 32 (Nuñez, Chapter 488, Statutes of 2006) requires California to reduce its greenhouse gas emissions to 1990 levels by 2020. On December 11, 2008, CARB approved a Scoping Plan, which is California's plan for meeting the greenhouse gas emissions reductions required by AB 32. The administration, implementation and enforcement of the Scoping Plan's measures will require a source of fiscal funding.

AB 32 also authorizes CARB to adopt a schedule of fees to be paid by sources of greenhouse gas emissions to support the costs of carrying out AB 32. The AB 32 Cost of Implementation Fee is included in the Scoping Plan, and the fee is authorized in Health and Safety Code Section (HSC) 38597, which states:

> “The state board may 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 revenues 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.”

Using this section as the basis for its authority, CARB proposes to establish a fee schedule to support CARB’s implementation of AB 32. On May 8, 2009, CARB noticed a Proposed Regulatory Order which contemplates the adoption of the AB 32 Cost of Implementation fee regulation. Generally, the revenues from the assessed fees would be used to pay the ongoing AB 32 program costs incurred by CARB and other state agencies, beginning in the 2009-2010 fiscal year, currently estimated at approximately $36.2 million per year.

Comments

A. The Administrative Fee Regulatory Language as Proposed Conflicts with AB 32’s Enabling Legislation and Sound Public Policy.

As an initial matter, El Paso conceptually supports an equitable, prospective, and transparent GHG fee imposed on sources of GHG emissions to recover CARB’s reasonable costs of administering, implementing and enforcing California’s AB 32 regime. As set forth in El Paso’s comments below, our concerns center on the proposed allocation of those administrative costs *away* from those actors on whom the statute clearly intended such costs be imposed and *toward* those actors who are not GHG “sources” within the meaning of the statute. CARB’s proposal thus runs impermissibly afoul both of the statutory command and sound public policy.

1. CARB's Proposal is *Ultra Vires* in Relation to the Enabling Statute.

The administrative fee currently proposed by CARB directly conflicts with AB 32's enabling legislation. California's Health and Safety Code Section 38597 states that the contemplated administrative fees are to be "paid by the *sources* of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001" (emphasis added). The AB 32 legislation defines a"[g]reenhouse gas emission source" or "source" to be any source, or category of sources, of greenhouse gas emissions whose emissions are at a level of significance, as determined by the state board, that its participation in the program established under this division will enable the state board to effectively reduce greenhouse gas emissions and monitor compliance with the statewide greenhouse gas emissions limit. Cal Health & Safety Code § 38550(i).

The statute could hardly be clearer. It unambiguously and unequivocally specifies that fees are to be collected only from *sources* of GHG emissions – i.e. the point of emission. Indeed, CARB's own Scoping Plan supports this reading of the statute. In the Scoping Plan, CARB lists recommended greenhouse gas reduction measures for both capped and uncapped sectors.[2] The cap and trade measure adopted by the Board is essentially a "hybrid" design, where electric generating facilities and large industrial sources are covered at the "*point of emission*". With respect to natural gas, small industrial combustion and the residential commercial sectors are covered "where the fuel enters into commerce". This is widely considered to be at the Local Distribution Company (LDC) level as noted in the Western Climate Initiatives (WCI) design recommendations released on September 23, 2008.

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[2] *See* "Climate Change Proposed Scoping Plan", Table 2: Recommended Greenhouse Gas Reduction Measures, issued October 2008.

In its recent Interim Decision,[3] the CPUC found that the natural gas sector has already employed technologies to mitigate and reduce emissions. The CPUC accordingly proposed to exclude the natural gas sector from the AB 32 cap-and-trade regulation at this time. Particularly in the case of interstate natural gas pipelines, the CPUC's exclusion makes imminent sense. Interstate pipelines do not "own" the natural gas they transport and, therefore, cannot control how the gas is used.

El Paso respectfully submits that CARB should redesign its fee proposal to ensure that any fees designed to recover the costs of administering, implementing and enforcing AB 32 be levied in a manner consistent with CARB's Scoping Plan, the CPUC's Interim Decision, the WCI's design recommendations, and the statute itself.

2. CARB's Proposal Collides with Sound Public Policy In the Regulation of Externalities.

In addition to the statutory and legal infirmities that burden it, CARB's proposal also suffers from a head-on collision with well-established public policy in the sound regulation of micro-economic externalities. The statute's requirement that "sources" pay administrative "fees" is intended to ensure that emitters internalize the full costs of their GHG emissions and to ensure that sound cost-causation principles govern recovery of governmental administrative costs. Such a cost-causation and cost-internalization approach has the salutary effect of encouraging behavioral change on the part of GHG emitters to reflect the true, total costs to society (including state government) resulting from their behavior. Recovering the administrative costs associated with implementing

[3] *See* "Interim Opinion On Greenhouse Gas Regulatory Strategies" issued on October 16, 2008 in Docket No. 06-04-009.

California's GHG program far upstream,[4] away from the actual source of the GHG emission – away from the point of combustion – defeats the basic public policy purpose that the Legislature embraced in mandating that administrative fees be collected from sources. This is so because actual *sources* of GHG emissions, after all, are the only actors in the regulatory framework that can actually respond to the "signal" from the administrative fee by modifying their behavior based on rational, cost-benefit decision-making. El Paso believes that these profoundly important principles of efficient and effective regulation of externalities militate powerfully in the direction of a modification of CARB's proposal: a modification that would ensure that the proposed administrative fee is only levied on those source-entities that are actually responsible for GHG emissions within the meaning of AB 32.

B. AB 32 Fees Should be Transparent to Actual GHG Emitters

In addition to requiring emitters to internalize the true costs of climate change externalities, all AB 32 fees should be *transparent* to the entity responsible for GHG emissions. Such transparency is essential to ensuring the emitter receives an accurate compliance price signal, reflecting the true and total costs arising from the emitter's behavior. The statute's expectations for substantial emissions reductions are highly dependent on the effective transmission of such signals. In El Paso's view, a fee imposed far upstream of the ultimate consumer (*i.e.*, the emitter) would be opaque, would send confusing price signals, and would contravene the AB 32 enabling legislation. By contrast, a transparent fee – one that is imposed directly on the actor immediately and

[4] The "upstream" sources in the natural gas sector include natural gas producers, processors and importers of natural gas (including LNG), transmission/storage and distribution companies. These facilities typically have relatively insignificant emissions compared to end users like a power plant or a large industrial facility.

ultimately responsible for the GHG emission – would ensure regulatory efficiency, effectiveness, accountability and optimal decision-making by the emitter.

C. The Ability of Interstate Pipelines to Pass Through Compliance Costs to Emitters is Uncertain, At Best.

CARB states that a "major goal of the proposed regulation is to equitably impose fees on the widest possible spectrum of greenhouse gas sources in an administratively feasible manner." CARB believes this "cannot be done unless some type of administrative mechanism is used to impose a 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." While CARB's goal of "equitable" distribution is admirable, the regulatory mechanism currently proposed is flawed. The costs of implementation, administration, and enforcement of AB 32 cannot be said to be "equitably" distributed when payment is required of entities that are not "sources" of greenhouse gas emissions within the meaning of AB 32. This inequity is magnified when such costs cannot be passed through to the actual emitters of GHG emissions, who are the true generators of CARB's administrative costs.

Initially, whether a Federal Energy Regulatory Commission ("FERC") jurisdictional pipeline can successfully pass on the cost of CARB's proposed fee is highly uncertain. As federally regulated entities, EPNG and Mojave generally may only recover their prudently incurred costs via rates in two ways. First, a pipeline may file a general rate case under Section 4 of the Natural Gas Act, which is an expensive and time-consuming process. It is highly unlikely that the timing of new rates incorporating CARB's proposed fee would or could coincide with the imposition of the proposed fee. This federal-state regulatory lag effect would itself be a strong source of compliance price signal distortion. Further, pipelines often settle rate cases with a provision precluding the pipeline from filing a general rate case for a specified period of time. This type of settlement provision prevents a pipeline from even attempting to file for rates that would have the effect of timely passing through the costs of the proposed administrative fee. Second, pipelines may file to implement a mechanism to track costs, such as CARB's proposed administrative fee. "Tracker" mechanisms are strongly disfavored, however, by EPNG and Mojave's rate regulating authority, the FERC.

Additionally, due to broadsweeping changes in FERC policy over the last two decades, regulated interstate pipelines increasingly confront pipeline-on-pipeline competition in the provision of natural gas transportation services to their customers. Such competition can often result in rate discount arrangements and other mechanisms to meet competition that result in effective rates that are charged below the maximum recourse rate permitted by FERC-approved natural gas tariffs. This fact of head-to-head rate-competition means that the well established micro-economic phenomenon of "tax incidence"[5] could routinely apply to FERC-regulated pipelines. Stated differently, marketplace conditions will determine whether, and to what extent, a pipeline can pass through CARB's administrative fee to customers in their rates. Again, such uncertainty risks distorting compliance price signals beyond recognition by emitters, resulting in sub-optimal cost-benefit decision-making about emission behavior.

In sum and for all of the foregoing reasons, CARB's *ex ante* expectation that its proposed administrative fees would automatically and certainly be passed through by pipelines to ratepayers is not well founded.

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[5] In economics, tax incidence is the analysis of the effect of a particular tax on the distribution of economic welfare. Tax incidence is said to "fall" upon the group that, at the end of the day, bears the burden of the tax.

Just as important, the relevant economic actor (*i.e.*, the carbon emitter) probably would not incur or even be aware of the fee, even if the pipelines *were* able to recover the CARB-proposed administrative fees in their regulated rates. As noted earlier, the carbon emitter should confront a transparent fee to ensure efficient economic compliance with the goals of AB 32. The problem with imposing CARB's administrative fee on regulated interstate pipelines is that transportation rates are paid by *shippers*, who are not necessarily *emitters*. For example, shippers include companies that merely produce natural gas at the well head. Shippers include entities that perform a purely merchant trading function in the marketplace. Shippers include other regulated interstate pipelines that choose, under their FERC-approved tariffs, to hold off-system capacity on a given pipeline. None of the foregoing shippers actually emits CO_2, and yet each would pay the proposed CARB administrative fee if it were embedded in the host pipeline's general transportation rates. Conversely, actual carbon emitters routinely do not contract for capacity on interstate pipelines, choosing instead to purchase their natural gas at the "end" of the pipeline – at a designated delivery point – and sometimes in the "spot" market. In that case, the pipeline has no contractual relationship at all with the emitter that supports charging a transportation rate, including CARB's administrative fee.

Thus, contrary to CARB's expectations under its proposal, pipelines are not only at risk for cost recovery but, even if they were able to pass through CARB's proposed administrative fee, it is unlikely that the fee would be borne by carbon emitters. Such a haphazard assessment of the administrative fee, in which it would fall randomly on non-emitters and emitters alike, would result in an inefficient and inaccurate compliance price signal to carbon emitters. Again, expectations for emission reductions are highly dependent on the effective transmission of the compliance price signal. In El Paso's view, a fee imposed far upstream of the ultimate emitter simply cannot successfully induce a change of behavior, is certainly not transparent and direct, and contravenes the spirit and intent of the AB 32 statute.

D. Imposition of CARB's Proposed Administrative Fee on Interstate Natural Gas Pipelines Would Constitute an Economic Barrier to Natural Gas Deliveries Into California.

Finally, imposing additional fees on California natural gas deliveries could potentially create a strong disincentive for shippers to select California delivery points for their natural gas supplies, choosing instead delivery points outside of California that serve other demand regions. This phenomenon could result in unintended constraints on available natural gas supplies, precisely at a time when California needs natural gas both as a clean-burning alternative to coal-fired power generation, as a reliability "backstop" for intermittent renewable energy sources such as wind and solar, and as a "bridge" to a new generation of sustainable energy technologies. In addition, imposition of CARB's proposed administrative fee could inadvertently burden proposals for expansions of existing natural gas pipelines and development of new pipeline projects serving the Golden State, by making California a relatively less attractive destination for natural gas supplies. El Paso respectfully urges CARB to consider these potential, unintended supply consequences from the broadsweeping reach of the proposed fee to recover the costs of administering, implementing, and enforcing AB 32.

Conclusion

El Paso appreciates the opportunity to offer these comments and suggestions to CARB, and to assist in the formulation of a fair and equitable administrative fee. El Paso also looks forward to ongoing collaboration and dialogue with CARB and interested stakeholders in further development of the AB 32 administrative fee.

By ______/s/________________

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