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VIA ELECTRONIC SUBMISSOIN

California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions and Conforming Amendments to the Definition Sections of the AB 32 Cost of Implementation Fee Regulation and the Cap-and-Trade Regulation

Arizona Public Service Company ("APS") is a wholly-owned subsidiary of Pinnacle West Capital Corporation and is engaged in the business of generating, transmitting, and distributing electricity in eleven of Arizona's fifteen counties. APS serves more than one million retail electric customers in Arizona and participates in the wholesale energy market. APS purchases from and sells energy to the California Independent System Operator ("CAISO"). APS does not own generation or serve retail customers within the state of California.

APS appreciates the opportunity to submit comments to the August 1st Amendments. APS recognizes the sizeable challenges that face the California Air Resources Board ("CARB") as it orchestrates the development of the western region's first carbon cap-and-trade program. To that extent, APS wants to ensure that the changes CARB proposes complement and align both APS's operational objectives and those objectives listed in the August 1, 2012 Staff Report: Initial Statement of Reasons for Rulemaking, which were succinctly summarized by CARB's Chairman, Mary Nichols and are paraphrased below:

- reduce greenhouse gas emissions in California while preventing gains in emissions outside of California; and
- provide clarity regarding the rules to which participants will be held accountable.

APS supports CARB's attempts at achieving the above two objectives, but has concerns that practical application of the current regulations will compromise electric providing entities' ability to assist CARB in meeting its obligations. Specifically, APS remains concerned with the following three issues, which were originally communicated in our June 25, 2012 Comments to the Revisions to the California Mandatory Greenhouse Gas Reporting Regulation:

1. Mandatory Reporting Regulation ("MRR") and cap-and-trade calculation methods that result in GHG emissions obligations associated with transactions that occur outside of CARB's jurisdictional boundaries.
2. A lack of clarity in the regulations regarding the process by which electric power entities ("EPE") determine their emissions reporting status among the following options: unspecified source of electricity, generation providing entity, and asset controlling supplier.
3. A lack of clarity in the regulations regarding the types of conduct or transactions that would trigger a finding of resource shuffling.

Additional explanation and proposed recommendations regarding our three concerns follow.

Concern #1: Mandatory Reporting Regulation and cap-and-trade calculation methods that result in GHG emissions obligations associated with transactions that occur outside of CARB's jurisdictional boundaries.

PROBLEM: Electricity purchases from and sales to the CAISO have unknown points of origin and consumption, respectively. However, it is known that instances exist where electricity generators outside the state of California produce power that is sold to the CAISO at the same time that electricity providers serve load outside the state of California using power purchased from the CAISO.

DISCUSSION: The CAISO operates the bulk of California's power grid and wholesale electric markets. It does so without ever taking ownership of the power, which means that electric entities, whether within or outside the state, that deliver power to a CAISO delivery point located within the state of California are the ones that will have a GHG emission compliance obligation beginning in 2013.

In CARB's October 2011 Final Statement of Reasons to California's Cap-and-Trade Program, CARB acknowledges that a provision "is necessary to address stakeholder concerns regarding 'simultaneous exchanges' and recognizes that this kind of exchange is similar to the wheeling of electricity through California, in that not all of the electricity being imported is actually used to serve California load." Thus, the qualified export ("QE") definition was modified to better resolve concerns regarding the wheel-through-like scenario. Unfortunately, this modification did not go far enough to address the blind wheel-through situations that sometimes occur with CAISO transactions.

When energy is delivered to the CAISO, the final point of delivery is unknown, and because electricity is fungible, in reality it ends up at several different locations, some of which are outside the state of California. For example, APS serves a portion of its load, which is located on the Arizona side of the California-Arizona border in Ehrenberg, with power purchased from the CAISO. Similarly, Valley Electric Association, Inc. ("VEA"

is an electricity service provider whose service territory is primarily located in Nevada) will be joining the CAISO in 2013. Both APS's Ehrenberg load and VEA's service territory are examples of load that is serviced through the CAISO but is located outside of the state of California.

At the same time, power that is purchased from the CAISO does not identify the original source of that power. And again, because power is fungible, it most likely is generated from many sources, some of which are not located within the state of California. Case in point, APS sells power into the CAISO from generating sources that are located in Arizona and New Mexico.

Therefore, there is nearly always a portion of the electricity that is generated outside of the state of California that is serving load outside the state of California, but is transacted through CAISO. Regulating these transactions falls outside of CARB's jurisdictional territory.

PROPOSED RECOMMENDATION: The QE allows for imports and exports that occur *simultaneously* to be netted within the same hour. Unfortunately, only allowing for intra-hour netting does not properly address the problem that "not all of the electricity being imported is actually used to serve California load." Another challenge is that transactions with the CAISO are blind and, therefore, it is unknown where power originates or is consumed. Furthermore, the calculation methodology does not fairly quantify netted emissions.

Therefore, APS recommends that the following changes be made to the regulatory language:

§ 95802 (225) "Qualified Export" means electricity that is exported in the same ~~hour~~ calendar year as imported electricity and documented by NERC E-tags. When imports are not documented on NERC E-tags, because a facility or unit located outside the state of California has a first point of interconnection with a California balancing authority area, the reporting entity may demonstrate ~~hourly~~annual electricity delivery consistent with the record keeping requirements of the California balancing authority area, including records of revenue quality meter data, invoices, or settlements data. Only electricity exported within the same ~~hour~~ calendar year and by the same importer as the imported electricity is a qualified export. It is not necessary for the imported and exported electricity (as defined in the MRR) to enter or leave California at the same intertie. Qualified exports shall not result in a negative compliance obligation for any ~~hour~~ calendar year.

§ 95852(b)(5) QE adjustment. An adjustment to the compliance obligation pursuant to the calculation in 95852(b)(1) may be made for exported and imported electricity during the same ~~hour~~ calendar year by the same PSE. Emissions included in the QE adjustment for qualified exports claimed by a first deliverer must meet the following requirements:

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

1. The ~~lower of either the~~ quantity of ~~exports or~~ imports (MWh) for the ~~hour~~ calendar year; multiplied by
2. The ~~lowest~~ weighted average of the emissions factors for ~~of any portion of~~ the qualified imports; minus
3. The quantity of imports (MWh) for the calendar year; multiplied by
4. The weighted average of the emissions factors for the qualified exports;
5. With zero being the maximum QE adjustment.

Additionally, APS recommends that the following be added in order to prevent market manipulation: "Establishment of a strawman for the primary purpose of maximizing an EPE's QE adjustment is prohibited."

Concern #2: A lack of clarity in the regulations regarding the process by which electric power entities determine their emissions reporting status among the following options: unspecified source of electricity, generation providing entity, and asset controlling supplier.

PROBLEM: Some entities may fit within the definitions of "asset controlling supplier" and "generation providing entities," while also importing power that meets the definition for "unspecified source of electricity."

DISCUSSION: Without clear guidance, EPE's are required to decide how to report emissions at the risk of discretionary enforcement for up to eight years after report verification. The risk and uncertainty involved may prevent entities from directly importing electricity into California, causing marketplace constraints that could be prevented through increased clarity within the regulations.

PROPOSED RECOMMENDATION: Add clarity to the regulations to give EPEs clear instruction to know whether they must register as an Asset Controlling Supplier or a Generation Providing Entity versus when utilizing the unspecified source of electricity is acceptable.

Concern #3: A lack of clarity in the regulations regarding the types of conduct or transactions that would trigger a finding of resource shuffling.

PROBLEM: In order to pursue emissions reductions that are real, permanent, quantifiable, verifiable and enforceable, electric power entities must be willing and able to participate in the program. Widespread concern related to the legality of a resource

shuffling attestation has been expressed in numerous forums and was recently acknowledged in Mary Nichols' August 16, 2012 letter to FERC Chairman Moeller.

DISCUSSION: As Ms. Nichols acknowledged in her August 16 letter, in order for "energy markets to work effectively, participants need a clear understanding of the rules to which they will be held accountable." To that extent, APS appreciates CARB's agreement to suspend for 18 months enforcement of resource shuffling attestations.

PROPOSED RECOMMENDATION: APS agrees that, as Ms. Nichols stated, "Additional rulemaking, as opposed to case-by-case guidance, is appropriate in order to define the types of conduct or transactions that would trigger a finding of resource shuffling." Such clarification will better inform cap-and-trade program participants' decision making and improve the long-term stability of the program. APS urges CARB to modify its regulations to add clarity to what constitutes resource shuffling and to the rules surrounding it. APS also requests that CARB clarify precisely on which dates the 18-month suspension period begins and ends.

CONCLUSION: APS respectfully requests CARB to (1) allow for annual netting of import and export transactions with the CAISO; (2) provide clarification of its expectations regarding EPEs that meet all definitions—unspecified sources of electricity, generation providing entities, and asset controlling suppliers; and (3) more clearly define resource shuffling and specify the content of the related attestation based on that definition.