Including Imported Electricity in a California Cap-and-Trade Program
Comments of Morgan Stanley Capital Group Inc.
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As a major supplier to California markets specifically, and one of the largest suppliers of electricity in the WECC in general, Morgan Stanley Capital Group Inc. (MSCG) is keenly interested in, and will be significantly impacted by, the implementation of California and WCI greenhouse gas emissions regulations. We have been actively involved in the discussion of how best to implement AB32 in California, going back to the work done by the CPUC and CEC to develop recommendations to the ARB for the electricity sector. We have consistently argued for source based regulation where feasible, and were the first party to argue that a First Jurisdictional Deliverer concept would be an improvement on the originally discussed First Seller concept.

We appreciate the opportunity to provide input on the issues discussed at the June 5 public meeting on imported electricity implementation issues. We were not able to participate in the meeting, and so are responding based on the presentation materials available from the web site. For that reason, our comments may not reflect discussions or clarifications that might have occurred at the meeting itself. If there is any desire for follow-up questions or discussion, please contact Steve Huhman, Vice President, at (914) 225-1592 or via e-mail at steven.huhman@morganstanley.com.

Q1: Which approach for including imports best lends itself to cap-and-trade?

A1: MSCG does not believe that there is a clear-cut answer to this question. It will depend at least in part, on which jurisdictions end up in the final WCI. Ideally, a First Jurisdictional Deliverer approach, applied to the entire WCI footprint, would be the most efficient. However, for this to work easily, WCI probably needs to end up as a contiguous entity (at least for jurisdictions within the WECC). If it is not, then the tracking becomes much more complex. For example, assume Washington is a WCI member, but that British Columbia and Oregon are not. Then visualize a power purchase moving from BC to California. Presumably, power generated in BC would be treated as "Delivered" at the Washington border, then would have to be tracked as an "export" where it entered Oregon, then re-recorded as "Delivered" at the California border. Perhaps someone can come up with an "elegant" solution to this challenge. However, absent that, a patchwork WCI seems likely to create significant headaches for a WCI-wide First Jurisdictional Deliverer approach. Therefore, given the uncertainty about precisely which jurisdictions will actually move forward and fully implement WCI, it appears that ARB must, at a minimum, prepare a fall-back, California-only plan.

Regardless of which "border" is selected as the point of administration, a methodology must be selected. MSCG believes it is likely to be rare that a particular import transaction can be accurately traced to a specific source that has a known and documented emissions rate. Therefore, our recommendation would be to assign a default emissions rate, and allow the importer the option of demonstrating it has sourced its

power from a specific resource with a particular emissions rate. The entity responsible for compliance should be the custodian of the power at the point in time the power crosses the jurisdictional border. Note that the “custodian” may not be the same as the “seller” or “owner”.

Q2: Are there other options that staff should consider for identifying obligated entities, and what criteria should we consider in determining the best approach?

A2: MSCG does not believe that using the e-tag to identify the “custodian” will be a problem-free approach, nor will it necessarily allow the specific physical source of the power to be identified. We are not aware of an approach that will allow an outside regulatory agency to unambiguously identify all sources and custodians of imported power objectively and independently. Therefore, it is our belief that the best practical approach, and perhaps the only realistic option, is to impose a self-reporting duty on all custodians, and rely on these reports.

Q3: What criteria should ARB use in selecting a tracking method for imported power?

A3: It must be recognized up front that the legislative duty imposed on ARB to track emissions for power imports has created an impossible task. This was fairly thoroughly vetted and established during the process to develop the CPUC/CEC recommendations to the ARB, and we are not aware of any new insights since those recommendations were developed that would change that conclusion. Therefore, it must be accepted up front that whatever method is chosen will be, at best, a reasonable approximation. In turn, that suggests that the criteria used should not attempt to develop an “airtight” system. Instead, the goal should be to create a system that is as reasonably accurate as possible while minimizing administrative costs for both the regulator and the market participants. One additional specific criterion should be that the method does not interfere with the practices preferred by the market to contract for, schedule and deliver power. Doing so would almost certainly increase costs for consumers, and potentially cause reliability problems, as well.

Q4: If ARB develops an attribute tracking system, would non-WCI generators participate?

A4: They would participate if they have an incentive to do so. This suggests that low emissions sources might participate if they thought it would give them a market advantage, while high emissions sources almost certainly would not. MSCG does not recommend trying to track non-WCI attributes, because we do not believe it is possible in most circumstances to track physical power from source to sink. All that would really be tracked is an implied contract for right to claim attributes. However, the practical result would be “contract shuffling”, so there would be no environmental benefit.

Q5: Is there enough of a locational difference in the resource mix in non-WCI imported power to warrant multiple default emission factors? If so, how could “contract shuffling” be prevented?

A5: MSCG has not heard a plausible proposal for preventing "contract shuffling", and does not believe it is possible. Consistent with our response to Q3, we therefore do not believe it is worth the ARB's effort to try to do so. Our view on this also informs our recommendation in Q1 to assign default emissions rates to imported power. With regard to use of a single or multiple default emissions factors, we do not have a well-researched analysis on this question, but generally, would support the use of 2-3 factors if the data supports doing so. Finally, on the question of assuming average versus marginal emissions data to develop default emissions factors, we believe that the argument in favor of marginal generation (and hence using the associated emissions to develop the default rate) going to support export markets is probably the best representation of how the markets would, in fact, contract. This might not always be strictly true where term contracts are involved, but for purposes of developing an approximate administrative rate, we think it is the best assumption.

Q6: Are there additional approaches to consider in setting emissions factors to calculate unspecified power?

A6: We have none to recommend at this time, but remain open to additional factors that others may recommend if we judge them to be well supported.

Q7: Should a reporting threshold apply to imported power?

A7: MSCG does not have a specific view on this issue, except to say that we are not opposed to some de minimis exemption level if others can make a case for it.

Q8: What criteria should be used in determining a default emission factor?

A8: We recommend essentially the same criteria here as we recommended for a possible tracking method in response to Q3. That is, reasonable accuracy, minimal administrative burden, and no interference with market contracting, scheduling or operating practices. It will be impossible to develop an "airtight" system, and so such a criterion should <u>not</u> be applied.