Comments of the Western Power Trading Forum

To the California Air Resources Board

On the Climate Change Draft Scoping Plan and Appendices

August 11, 2008

The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (ARB) on the draft Scoping Plan for achieving California's greenhouse gas reduction goals under Assembly Bill 32.

WPTF is encouraged by ARB's endorsement of a multi-sector cap and trade program within the context of the regional Western Climate Initiative as key element of the scoping plan. However, WPTF members are concerned that ARB's reliance on additional regulatory measures on capped sectors, such as an increase in in the state's Renewable Portfolio Standard, may undermine the efficiency of the cap and trade system and increase costs of achieving emission reductions under AB32. WPTF also argues that certain other measures under evaluation, specifically an upstream carbon fee and coal emission standard, would be duplicative of the cap and trade system.

Our comments below are organized as follows. Section I provides comments on the cap and trade system, and the design elements recommended in the most recent WCI design document. Section II addresses the renewable portfolio standard and Section III addresses upstream carbon fees and the proposed coal emission standard. WPTF does not

[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

provide comments on proposed emission reduction measures for sectors other than electricity.

I. A Cap and Trade system should be the core of California's GHG reduction plan

A cap and trade approach is the most cost-effective way to reduce GHG emissions over the long-term and WPTF strongly supports ARB's decision to adopt a multi-sector cap and trade system as a core element of its scoping plan. We also welcome ARB's intention that California implement its cap and trade program as part of the broader, regional Western Climate Initiative. The broader the scope and coverage of GHG cap and trade system, the more opportunities for low cost emission reductions will be available to the market, and the lower the risk will be for emission leakage. Therefore, we encourage ARB to link California's system to other GHG markets, such as the Regional Greenhouse Gas Initiative.

WPTF notes that the WCI recommendation on the design of the cap and trade system that was included in the appendix to the scoping plan has now been replaced by a WCI draft design document released by WCI on July 23rd. WPTF understands that ARB is looking to the WCI process, rather than a separate process, to develop and resolve the details of the cap and trade system. As such, WPTF provides comments on some of those design issues as presented in this latest WCI document. We will also reflect these views in our submission to the WCI, due on August 13th.

Scope: In order to maximize opportunities for low-cost emission reductions, the scope of the cap and trade system should be as broad as practicable. In this regard, we support the inclusion of the electricity sector; industrial and commercial combustion; industrial processes; and residential, commercial and industrial fuel combustion.

Giventhe high and growing proportion of GHG emissions from the transportation sector, we also applaud California and the other WCI members for seeking to capture these emissions in the trading system. However, we are also cognizant of the technical complexity and political challenges of including the transportation sector. For this reason, we are concerned that incorporating transportation at this time would unduly delay or impair implementation of the cap and trade system

Point of regulation: WPTF supports the proposed points of regulation for the various sources identified for inclusion in the program, and in particular, endorses the 'first jurisdictional deliverer' (FJD) approach as appropriate for the electric sector. In this regard, we note that ARB's scoping plan does not contain a clear endorsement of FJD, but rather indicates that California is "examining the First Jurisdictional Deliverer as the point of regulation for the electric sector…". The First Deliverer approach is the appropriate point of regulation for the electricity sector because it is compatible with an eventual source-based federal system, and will minimize emission leakage. We therefore urge ARB to accept the recommendations of the WCI, the California Market Advisory Committee, the California Public Utilities Commission and the California Energy Commission and firmly endorse the First Deliverer approach in the final scoping plan.

Apportionment of cap and distribution of allowances: Unlike California, most WCI members have not adopted legislation setting a state or provincial GHG cap. Nor have they indicated commitment to the level of emission reductions required by AB32. In addition, the WCI draft design document anticipates that WCI members will have a great deal of discretion in determining the method of allocating allowances to capped entities. Because of these potential differences in the level of individual caps and the method of

allocation allowances, there is a real risk that the cap and trade system will put California entities at a competitive disadvantage relative to entities in other WCI jurisdictions. This is of particular concern to power generators, who compete for access to power markets across the West. We therefore urge ARB to use its influence within WCI to push for harmonization of allocation methods, in particular for the power sector.

Temporal flexibility: Temporal flexibility for capped entities is an important means of containing costs of the GHG trading system. For this reason, WPTF supports the WCI's recommendation for unlimited banking of allowances and three year compliance periods, and urges ARB to do likewise. However, we note that discrete compliance periods provide entities with flexibility to use future year allowance budgets in the early years of the compliance period, but increasingly limited flexibility as the compliance period progresses, and no flexibility in the final year. If the final year turnss out to be anomalous due to weather and economic conditions, then capped entities could have difficulty acquiring sufficient allowances for compliance. In order to avoid this unintended consequence, WPTF suggests that ARB and the WCI establish rolling compliance periods. Under this approach, capped entities would be required to surrender allowances annually to cover emissions in the previous year, but in exchange would always be able to use a limited quantity of allowances from the next year (plus any allowances banked from previous years).

Enforcement: Section 12.3 of the WCI draft design document states:

> If by the deadline for demonstrating compliance a covered entity or facility does not have sufficient allowances to cover its emissions for the previous compliance period, it shall be required to surrender three allowances for every metric ton not covered by an allowance at the deadline.

WPTF understands that the intention of this penalty is to deter non-compliance and, at the same time, to make the environment whole by ensuring that allowances are retired to cover the excess emissions. However, we are concerned that the penalty provision that calls for a non-compliant entity to secure triple the number of allowances will increase demand for allowances, and thus allowances prices, and that the brunt of that will be borne by entities that have been fully compliant. For this reason, WPTF recommends that the penalty be levied financially, rather than in allowances, i.e. entities that do not surrender sufficient allowances should be required to pay a financial penalty equal to the market price of allowances multiplied by some multiplier (greater than one). The State would use a portion of the penalty to purchase and retire allowances or offsets equivalent to the quantity of excess emissions. In this way, the environment is made whole, but the non-compliance penalty does not create additional pressure on the allowance market or unnecessarily increase the costs of allowances for entities that performed their obligations.

II. An enhanced RPS is flawed as a GHG reduction measure and may undermine the efficiency of a cap and trade system and raise compliance costs.

WPTF recognizes that renewable energy clearly will and must play an integral role in reducing GHG emissions. However, reliance on a prescriptive regulatory approach, such as raising the renewables portfolio standard to 33%, reduces compliance flexibility and potentially misses cheaper GHG reduction opportunities, ultimately undermining the economic-efficiency of a cap and trade system. Because the ARB's economic analysis is not yet available, it is not possible to assess the cost of per ton of emission reductions through renewable energy development relative to emission reductions achieved through other means or sectors. However, recent analysis of the

California Public Utility Commission suggests that increasing the RPS to 33% would be costly as a GHG measure. Modeling conducted for the CPUC as part of the GHG proceeding found an implicit carbon price for incremental new renewable beyond the current 20% RPS to be around $133/ton.[2] While the relative cost of GHG emission reductions in various sectors is unknown, the results of the GHG analysis conducted by the CPUC bring the cost-effectiveness of an increase in the renewables mandate to 33% as a GHG regulatory strategy squarely into question.

Further, because the RPS is by definition technology-specific, it erects barriers for alternative GHG control technologies. This outcome is inconsistent with the State's objective to support a range of GHG technologies to achieve long-term emission reductions– not just renewable energy:

> To reduce emissions to the level needed by 2050, California needs to promote innovation that produces significant improvement in technology and infrastructure. Furthermore, we must ensure that the policies and technologies deployed over the next few years do not detract from the implementation of even more promising technologies that emerge in the future.[3]

Regulators and policy makers must be careful that in establishing GHG reductions programs, they do not pick technology winners and losers. While renewable energy technologies will undoubtedly be part of climate change solution, other technologies, will also play important roles. By establishing renewable resource development as the state's preferred approach for reducing GHG emissions, the RPS creates barriers to the development and deployment of alternative and emerging technologies, that may turn out to be more cost-effective in the long-term.

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[2] Energy and Environmental Economics Incorporated, Presentation on the results of GHG modeling at: http://www.ethree.com/GHG/E3_CPUC_GHGResults_13May08%20(2).pdf

[3] Appendix at C-58

In contrast, a cap and trade system would provide strong incentives toward development of renewable resources, but it would also place renewable energy and other emerging GHG technologies on equal footing by allowing the market to find these opportunities when they become cost effective.

III. Application of carbon fee and/or a separate coal emission standard is incompatible with a multi-sector cap and trade system.

The draft scoping plan indicates that ARB is still considering the use of broad carbon fees to achieve emission reductions under AB32:

> ARB is currently evaluating several possible design scenarios that could be used for a carbon fee program. Under a "downstream" approach, fees would be imposed on facilities that fall within ARB's mandatory reporting jurisdictional authority. This would include facilities like power Sector Overview and Emission Carbon Fee Reduction Strategies plants, electricity retail providers and marketers, oil refineries, hydrogen plants, cement plants, cogeneration facilities, and other industrial sources that emit more than 25,000 tons per year of CO2. Under this approach, transportation sources of GHG emissions, which account for approximately 40 percent of statewide GHG emissions, would not be covered.
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> Under an "upstream" approach, fees would be levied at or closer to the point that natural gas, gasoline, diesel fuel, and electricity imports enter the California economy. This option would achieve broader coverage of emissions sources, potentially covering over 90 percent of GHG emissions in the state if expanded to include industrial process and high global warming potential emissions. It would also be possible to implement a fee that reflected a hybrid of the two primary approaches.
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> The level of the fees would need to be set based on economic modeling to evaluate the amount of emission reductions likely to be achieved from different fee levels. To incent significant reductions, fees would likely need to be set between $10 to $50 per metric ton of $MMTCO_2E$. For every $10/metric ton, the fees would increase the wholesale price of coal-fired electricity by $0.01 per kilowatt-hour, of gasoline by $0.10 per gallon, and natural gas by $0.05 per therm. While this type of price signal would have some effect on consumer buying patterns, the larger effect would be on the investment decisions and fuel choices made by suppliers of goods and services.[4]

[4] Appendix at C-182

Broad application of carbon fees may have merited consideration as a GHG reduction measure in the development of the scoping plan, as an alternative to a cap and trade system. However, it would be duplicative to consider imposition of such fees in conjunction with a multi-sector cap and trade system, since this would result in double-regulation of emissions from fuels – once at the distribution level and again when the fuel is combusted for electric generation or other use. Now that ARB has endorsed a cap and trade system as a central component of its scoping plan, it should recognize that the implementation of carbon fees as a GHG reduction tool is duplicative. WPTF recommends that discussion of carbon fees be removed from the final scoping plan.

Likewise, WPTF is concerned that ARB is evaluating a 'Coal Emission Standard' for possible inclusion in the scoping plan. As we understand this option, load-serving entities would be required to reduce emissions associated with imports of electricity from coal-fired generators by divesting of or eliminating purchases from these resources, implementing carbon capture and storage or acquiring emission offsets. WPTF believes that such command and control mechanisms should not be necessary where there are cap and trade programs; that is, a cap and trade system that regulates first deliverers in the electric sector will encourage divestment from coal, and development and implementation of CCS without the need for a duplicative and potentially conflicting emission standard. For these reasons, WPTF generally opposes a coal emission standard and requests that it be removed from the scoping plan.