

# Attachment 1

# INDEPENDENT ENERGY PRODUCERS

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July 10, 2013

Mary Nichols, Chair  
California Air Resources Board  
P.O. Box 2815  
Sacramento, CA 95812

**Re: Resource Shuffling is Undermining the Integrity of AB 32 Implementation**

Dear Ms. Nichols:

I am requesting California Air Resources Board (“CARB”) action to correct protocols that are causing “leakage” in California’s carbon emission reduction goals and potentially inciting resource shuffling practices, both of which are detrimental to in-state wholesale electric generators and the integrity of the California Cap and Trade (C&T) program.

The Independent Energy Producers Association (“IEP”) represents over 26,000 MWs of installed renewable and natural gas electrical generation capacity serving California. IEP has worked with CARB to achieve an efficient and effective C&T program to reduce carbon emissions. We have focused on ensuring that the C&T program supports a competitive, level playing field in the electric generation sector. IEP has been particularly concerned that the C&T program treats in-state resources comparable to out-of-state resources exporting their power into California. The CARB, to date, has been very responsive to the issue of avoiding leakage. However, recent studies indicate that the current regulations may not be achieving the carbon reduction goals sought. Rather, while lowering emissions from in-state generation, the rules may have the effect of increasing the total amount of emissions associated with the electric sector regionally and fostering so-called “resource shuffling.”

In order to avoid “leakage” of emissions associated with the implementation of the C&T program, CARB imposed a GHG emission obligation on “First Deliverers.” As First Deliverers, in-state generators have an obligation to report annual carbon emissions “out of the stack” and purchase carbon allowances matched to those reported emissions. On the other hand, First Deliverers of imported power report the emissions if the import derives from “specified” resource located out-of-state. If the import is not identified with a specified resource located out-of-state, the imported power is treated as “unspecified” system power. In the latter instance, CARB assigns a default emissions factor to the unspecified system power. The CARB methodology for imputing emissions for unspecified system power is calculated as a rolling three-year average of the marginal plants in the Western Interconnection, where marginal plants are defined as facilities producing at 60% of generating capacity or less.<sup>1</sup> This approach effectively deletes coal generating facilities from the calculation of emissions associated with unspecified imports.

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<sup>1</sup> Energy Institute at Haas, “Downstream Regulation of CO2 Emissions in California’s Electricity Sector,” James Bushnell, et al, January 2013, p. 6

At the time, IEP and others raised concerns that if the imputed emissions factor of unspecified imports was not set correctly, then the C&T regulations would be creating an incentive for First Deliverers to hide the carbon emissions associated with their imported power. IEP believes the current CARB methodology creates a clear incentive for a party with a portfolio of relatively high emitting base load (coal) resources to categorize its whole portfolio as “unspecified” in order to create a competitive advantage by avoiding its full carbon allowance obligation.

Recently, evidence has emerged that supports the concerns voiced by IEP that the CARB’s treatment of unspecified imports would result in parties quickly adjusting their import schedules in order to minimize if not outright avoid their true compliance obligation. On May 8, 2013, the Arizona Public Service (APS) communicated to the marketplace that *any* power that is sold from APS should be treated as having been generated from the APS power system and not specifically by a specific generating resource. (See separate attachment) In effect, APS is announcing that all its export sales to California (and others) will now be unspecified, system power. If left unchecked, one can be confident this practice will spread.

This is important because, while the APS communication alludes to power tagged from the relatively emission free Palo Verde Generating Station, in reality nearly two-thirds of the 2012 APS generation portfolio is comprised of high carbon emitting coal (38%) as well as natural gas (24%).<sup>2</sup> This APS power competes directly with California in-state natural gas generation (as well as other imports).

Why should California care? A C&T program that fosters this type of behavior undermines California’s goal to actually reduce carbon emissions from the electrical generation fleet serving California. I refer you to a study recently completed related to this subject: [Downstream Regulation of CO2 Emissions in California’s Electricity Sector](#), James Bushnell, et al, (Energy Institute at Haas, Working Paper Series, Berkeley, CA, January 2013).

Professor Bushnell’s study examines the implications of alternative forms of cap-and-trade regulations on the California energy sector. Specific focus is on the potential impacts of the “downstream” form of regulation, i.e. the First Deliverer policy. As he has found, absent strict non-economic barriers to changing import patterns, such policies are extremely vulnerable to reshuffling of import resources. The paper makes two important observations:

1. “... many of the high emitting resources that first deliverers could seek to launder are baseload or otherwise operating at a high fraction of capacity. As a point of reference, the California Energy Almanac reports that in 2009 more than 20,000 GWhs of specified coal power was imported into California. If all of these resources were to somehow become unspecified, it would result in approximately 10 mm Tons of *paper* emissions reduction. That quantity is roughly equivalent to the entire 2012 annual allocation of emission allowances to the oil and gas extraction sector, the second largest industrial sector regulated under the program.” (p. 6, emphasis added)

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<sup>2</sup> Arizona Public Service Company, 2012 Integrated Resource Plan, p. 6

2. "Reshuffling could occur if low or zero GHG resources, which currently serve out-of-state baseload, were reassigned to California and higher emitting out-of-state resources, which currently serve California, were reassigned to serve the out-of-state baseload." (p. 7)

Importantly, the paper concludes the following:

"The most obvious and significant result is that none of the California regulations has much of an impact on WECC total emissions. The source-based California cap produces an allowance price of just under \$13 a ton, but almost all of the 6 mm Ton reduction in California is offset by increases in emissions in the other WECC regions." (p. 20).

"Under the assumption that default emissions are 428 tons/GWh, a substantial amount of baseline coal energy (all that is not under contract) is imported as default energy [*i.e. unspecified*], which is treated as if its emissions were quite a bit lower than their true values. (p. 22, emphasis added]

Presently, at the Board's direction, CARB staff is re-visiting the issue of resource shuffling. We welcome the attention to this matter, but we believe the problems associated with resource shuffling links directly to the methodology for imputing emissions for unspecified system power imported into California. In order to solve this problem, Professor Bushnell, et al., recommend increasing the default emissions factor associated with unspecified power such that it represents the emission of a coal facility rather than a clean, natural gas facility operating on the margin of the supply curve. IEP supports this approach.

IEP has always supported and many IEP members participate in a broad wholesale market encompassing the WECC. However, the C&T program will only work if it is fair, non-discriminatory and actually reduces carbon emission associated with electricity production directly serving California consumers and, indeed, serving consumers throughout the WECC as this is a global problem. California's in-state electric sector has a relatively low carbon footprint based upon renewable, hydro-electric, nuclear and low emitting natural gas generation. In addition, California's natural gas generators are subject to the emissions performance standard ("EPS") as well as the C&T regulations. Overall, IEP members have invested billions of dollars in response to California's policy to de-carbonize the electric sector. They should not be put at a competitive disadvantage by out-of state generators camouflaging higher carbon generation as "system imports."

Thank you for your consideration of this important matter.

Respectfully submitted,

A handwritten signature in black ink, appearing to be the initials 'JEP' followed by a stylized flourish.

Jan Smutny-Jones  
Executive Director

Cc: CARB Board Members:  
John R. Balmes, M.D  
Sandra Berg  
Hector De La Torre  
John Gioia  
Judy Mitchell  
Barbara Riordan  
Ron Roberts  
Daniel Sperling  
Phil Serna  
Alexander Sherriffs  
Richard Corey, Executive Officer  
Steve Cliff, Branch Chief of C&T Program



May 8, 2013

**Distributed To: All APS WSPP and EEI Counterparties**

**Re: California Cap-and-Trade Resource Shuffling Concerns**

Arizona Public Service Company ("APS") has been receiving inquiries from counterparties related to selling resource-specific energy for subsequent import to California for the purpose of avoiding a carbon obligation. APS believes this could constitute resource shuffling because replacement energy for APS' load and obligations would likely come from coal or gas resources.

Therefore, APS is distributing this communication to its counterparties in order to clarify that any power that is sold from APS has been generated by the APS power system and not specifically by a specific generating resource. For example, power that is tagged with Palo Verde Nuclear Generating Station listed as the Source on the e-Tag consists of power that may have been generated from a mix of resources, including coal, gas, nuclear, renewable, and market purchases. The e-Tag may identify Palo Verde Nuclear Generating Station as the Source. However, APS is selling system resources and not generator-specific power.

Counterparties should review California's Mandatory Reporting Regulation ("MRR") (Title 17, California Code of Regulations ("CCR"), Sections 95100-95158) and the Cap-and-Trade regulations (Title 17, CCR, Sections 95800-96023) in order to determine their own obligations when selling power that is California-bound.

APS understands that the California Air Resources Board has a revision to its original Resource Shuffling Guidance due out this June for public comment. APS will re-examine its position once the revised guidance has been approved and finalized.

If you have any questions, please contact Jeanine Divis at (602) 250-3797.

Sincerely,

A handwritten signature in blue ink, appearing to read "Justin Thompson", with a long horizontal flourish extending to the right.

Justin Thompson  
Director of Business Support, Marketing & Trading