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Via Electronic Submission

Steven S. Cliff, Ph.D.
Chief, Climate Change Program Evaluation Branch
Stationary Source Division
California Air Resources Board
P.O. Box 2815
Sacramento, CA 95812

Re: Comments of Powerex Corp. on the Stakeholder Workshop re Cap-and-Trade Compliance Requirements for First Deliverers of Electricity

Dear Mr. Cliff:

On behalf of Powerex Corp. ("Powerex")[1], I submit the following comments in response to the California Air Resources Board's ("ARB's") request for comments at the May 4, 2012 stakeholder workshop on Compliance Requirements for First Deliverers of Electricity, also referred to as the Cap-and-Trade Program Electricity Workshop (the "Workshop"). First, we wish to express our appreciation for ARB's convening of the Workshop, and this opportunity to provide comments. We also understand that ARB plans to convene at least one more such workshop to address this important matter, and we welcome that as well.

In the current power market, a tremendous amount of optimization occurs to save transmission costs and to manage regional generation and load uncertainty at the lowest cost. Purchases of power from both specified sources and unspecified sources are regularly made

[1] Powerex is a corporation organized under the Business Corporations Act of British Columbia, with its principal place of business in Vancouver, British Columbia, Canada. Powerex is the wholly-owned energy marketing subsidiary of the British Columbia Hydro and Power Authority ("BC Hydro"), a provincial Crown Corporation owned by the Government of British Columbia. Powerex sells wholesale power in the U.S., pursuant to market-based rate authority granted by the Federal Energy Regulatory Commission ("FERC") in October 1997, renewed most recently effective January 1, 2009. Powerex sells power from a portfolio of resources in the U.S. and Canada, including Canadian Entitlement resources made available under the Columbia River Treaty, BC Hydro system capability, and various other power resources acquired from other sellers within the U.S. and Canada. Powerex also buys and sells power in Canadian provinces other than British Columbia and in Mexico. Powerex has been delivering power to California since shortly after receiving its market-based rate authority in 1997.

without a predetermined physical destination for the output of those facilities. Instead, the output is taken into a broad portfolio of resources and dynamically managed on a daily *and hourly* basis, taking into account frequently changing market conditions and transmission constraints. These are legitimate actions within the electricity market and have long been well understood by regulators. What is not well understood is whether certain of these long-practiced, legitimate market activities may constitute "resource shuffling" in the context of carbon related price signals in the electricity market.

Given the size of California's electricity market, not to mention the precedential importance of California's cap-and-trade program, the key is to get this right *before* the launch of the Cap-and-Trade Program in January 2013. The stakes are high. The Cap-and-Trade Regulation has the potential to fundamentally change the dynamics of this market both inside and outside of California. It is therefore critical that ARB give market participants sufficient guidance to be able to distinguish between what is and what is not resource shuffling.

The Board recognized this when it adopted Resolution 11-32 last October. Significant work still remains to be done to address the Board's directive to ARB staff in that resolution,

> to identify and propose, as necessary, during the initial implementation of the cap-and-trade program, potential amendments to the [Cap-and-Trade] Regulation including, but not limited to . . . [the] Definition of Resource Shuffling to: (a) provide appropriate incentives for accelerated divestiture of high-emitting resources by recognizing that these divestitures can further the goals of AB 32; and (b) ensure changes in reported emissions from imported electricity that serves California do not result merely in a shift of emissions within the Western Electricity Coordinating Council region, but reduces overall emissions . . . .

As discussed more fully below, we do believe that amendments to the Regulation will be necessary to provide the clarity and certainty that market participants need. Please note that these comments are not intended to be exhaustive. We touch only on the issues that arose during the Workshop that are of greatest importance at this time; we look forward to additional opportunities to engage with ARB on these issues in the months ahead.

I. The Definition of Resource Shuffling Requires Clarification.

The definition of "Resource Shuffling" in Section 95802(251)[2] is too vague and too subjective to provide the regulated community with adequate certainty as to what ARB will

[2] Section 95802(251) provides: "'Resource Shuffling' means any plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid."

consider to be legitimate electricity imports and which it would deem to constitute illegal "resource shuffling." There are two critical problems with the definition. First, the term "any plan, scheme, or artifice" is inherently subjective and requires *ex post facto* determinations of intent. What a member of the regulated community may genuinely believe to be a plan to pursue normal market incentives may be viewed by another as an illegal "plan, scheme, or artifice." Second, as used in the definition, the term "emission reductions" is necessarily comparative, most likely with respect to the mix of electricity historically imported to California. That comparative framework is not provided in the definition, however.

As the comments of many in the regulated community at the May 4 workshop made clear, additional guidance is critically needed. It can and should take the form of formal guidance documentation, and should include clear, concrete examples of both permissible market conduct and impermissible "resource shuffling." In addition, we call upon ARB to develop a formal process by which individual entities can obtain a determination in advance by ARB that any proposed market activity is permissible or impermissible. We are sensitive to the need to avoid promulgating "underground regulations," but regulated entities that are willing to be transparent ought to be able to receive clear guidance from ARB so that they can comply with the Regulation. Providing such guidance likely would go a long way toward addressing the concerns with respect to the vague and subjective nature of the current definition. It would be far better to do so in advance rather than via costly enforcement proceedings in the future.

Lastly, with respect to the second concern with the necessarily comparative aspect of the term "emission reductions" as used in the current definition, Powerex supports the alternative definition proposed by the Western Power Trading Forum. This definition builds upon the comparative terminology in ARB's July 15, 2011 first proposed 15-day modifications — which terminology appeared to inform many of the examples discussed by ARB during the Workshop — while at the same time clarifying the ambiguities with that earlier definition.

II. The Qualified Export Adjustment Requires Adjustment.

On Slide 29 of ARB's presentation at the May 4 Workshop, ARB presented several options with respect to the QE Adjustment. Powerex continues to support ARB's proposal to include a QE Adjustment in the Cap and Trade Regulation. Indeed, without a QE Adjustment, the Cap-and-Trade Regulation may have distorting effects on the California energy market. We therefore do not support Option 1 on Slide 29 (*i.e.*, to eliminate the QE adjustment). A properly crafted QE Adjustment could solve the problem by removing any incentive for the importer to select a wheel through over a set of import/export transactions for the same hour.

The key is to craft the QE Adjustment properly so as to achieve this purpose; unfortunately, the current draft does not do so. Powerex therefore also does not support Option 3 on Slide 29, which is to leave the QE Adjustment in Section 95852(b)(5) unchanged. ARB's Option 2, which is to amend the Regulation "to allow importers to only receive credit for

simultaneous exchanges with the same counterparty and same quantity of MW" is unduly restrictive in light of the realities of the complex and highly dynamic power markets (see above). Therefore, Powerex supports ARB's Option 4, to amend the Regulation to adopt one of the approaches recommended by stakeholders.

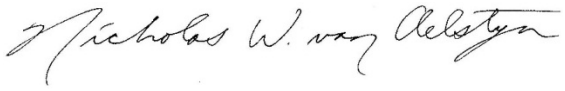
There are several different alternatives that likely would work sufficiently well. Powerex still supports the "weighted average within the hour" approach that we outlined in our September 27, 2011 comments. We also think that the "stacking" approach previously proposed by Southern California Edison and discussed at the May 4 Workshop likely could achieve the objectives of the QE Adjustment. This also is consistent with the approach proposed by the Western Power Trading Forum in which the Regulation is amended to assign emission rates to qualified exports in ascending order from the lowest, non-zero import within each hour. Each of these alternatives serves to balance the incentives of the market participants and reduce the number of wheel through transactions.

With respect to both the definition of Resource Shuffling in Section 95802(251) and the QE Adjustment in Section 95852(b)(5), the key is to get it right before the launch of the Cap-and-Trade Program in January 2013. This will require adopting amendments to these provisions, as the Board contemplated in Resolution 11-32. As discussed above, doing so also requires the promulgation of formal guidance documents, and the establishment of a formal process for market participants to obtain in advance clear guidance with respect to specific market activities that they might undertake.

* * *

Thank you for your consideration of these comments. Powerex applauds ARB for its continued work to implement the mandate of AB 32 and, in particular, its work on market-based compliance mechanisms. If you have any questions on the enclosed comments, please contact me, at 415-262-4008 or nvanaelstyn@bdlaw.com.

Sincerely,



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